Scotianomics
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Discussion Paper

Benefit Corporation Tax Credits: A Proposal

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About Scotianomics

In the 21st century data is everywhere but it is the analysis that transforms data into valuable, actionable knowledge that is key to success.

Organisations, both in Scotland's private and public sectors, lack access to useful, reliable data and value-added analysis of the kind that most advanced countries take for granted. This creates a hidden but real disadvantage for Scottish business, limits public policy and disrupts the pursuit of shared prosperity.

Scotianomics aims to spark a knowledge revolution and inform the decision-makers on Scotland's economy. We provide cutting-edge intelligence and strategic planning resources so that stakeholders can gain a wide view of the threats and opportunities in the world through our geopolitical, economic and policy analysis, unique historical datasets, risk and opportunity forecasts, Geographic Information System mapping solutions and strategic planning services.

Gordon MacIntyre-Kemp

Director

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Executive Summary

- The UK's tax revenue generation is more centralised than most of the other developed economies.
- The UK government agreed to devolve power over corporate taxation to NI but not to Scotland, creating unfair competition.
- The UK leads the G20 corporate tax rate race to the bottom but justified its decision to not devolve corporate tax powers to Scotland because this would lead to a race to bottom within the UK.
- Lower corporate tax rates are considered to be increasing competitiveness and investment but this is a view based on conservative politics and neoliberal economics that is not necessarily supported by the relevant literature.
- The fact that there is a negative relationship between corporate tax rates and income inequality is overlooked as a wider values-based approach to economics is not utilised — thus any gains from tax cuts are unsustainable.
- There is a negative correlation between income inequality and productivity and this is damaging the UK economy.
- There is an observable positive, (even indirect) correlation between higher corporate tax rates and higher productivity.
- The Scottish government should demand power over corporate taxation to utilise that power for a purpose that is aligned with the specific needs of Scotland's requirements for balanced and sustainable economic growth to avoid being forced by the UK Government to follow a failing trend.
- Linking corporate tax to the Scottish Business Pledge could be the way forward.

Introduction

This report can be seen as a response to the announcement by the UK Government of a further 1% decrease in corporate tax rate, from 1 April 2020, to 17%. The main aim of the report is to investigate and challenge the reasoning behind this decision. It demonstrates that what informs the UK Government's corporate tax cuts are mostly the political positioning and the political agenda of the Conservative party rather than the actual effect of the policy.

In response to that, it suggests that corporate tax powers should be devolved to the Scottish government in order for it to be able to address the needs of Scotland. Assuming that there is no logical basis for denying these powers to Scotland, it proposes that the Scottish government should incentivise corporate tax rates through its Business Pledge; a business scheme initiated by the Scottish government in partnership with businesses headquarter in Scotland for the promotion of sustainable economic growth. The report identifies this as the best way to address Scotland's productivity and income inequality issues, which are disregarded by the tax-cuts approach of the UK government. As a result, the recommendations of this report are concerned primarily with promoting change in the reasoning behind corporate tax policy making.

The methodology it employs is qualitative in nature and is known as the 'What the Problem is Represented to be' (WPR) method (see Appendix 1). The WPR method is utilised by this report in order to provide an analysis of the UK's government policy to cut corporate tax and formulate its own proposal on how should the Scottish government act regarding the same issue. The report follows the basic guidelines of the WPR method, and is structured to address the following issues:

- What is the problem corporate tax cut policies aim to address?
- What are the political and economical underpinnings of this approach?
- What are the politico-economical issues that are silenced or disregarded?
- What are the effects of this?
- How a Scottish corporate tax policy could overcome the issues created?

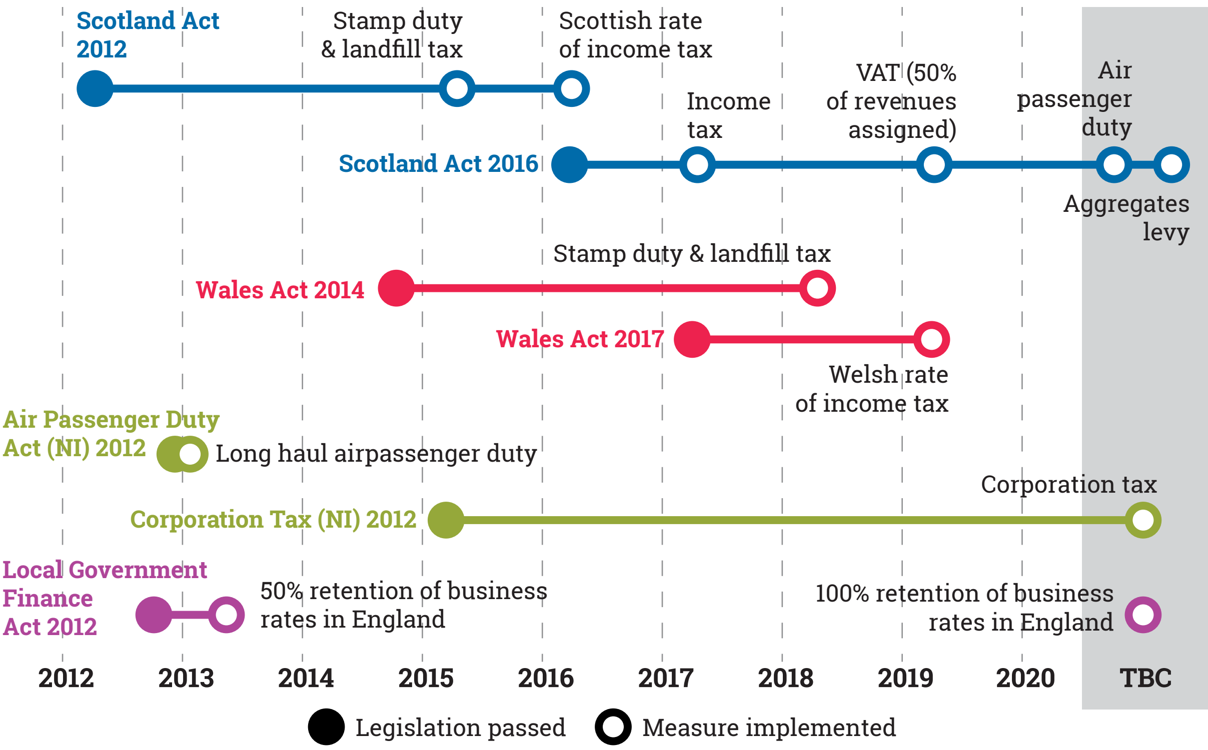
Corporate taxation as an instrument to increase competitiveness

This section looks to identify what the problem is represented to be in the case of the further corporate tax cuts policy announced by the UK government. It looks into the general functionality and relationship between the central government and corporate taxation. After that it offers a brief discussion on the fact that corporate tax cuts are employed by the UK government as a means of achieving economic growth, through increased competitiveness of businesses.

UK's centralised tax system

To start with, it must be stated that corporate taxation is not one of the powers that have been devolved by the UK government to the Scottish parliament.[1] In fact David Cameron, when he was the Prime Minister of the UK, following the Scottish referendum in 2014 refused to grant Scotland with the power to set its own corporate tax rate. Taxation in general and corporate taxation in particular, have been traditionally seen as the responsibilities of a sovereign government. As a result, the Scottish government does not have tax-raising powers over the VAT, National Insurance, and corporate tax.

Figure 1: Tax devolution measures announced between 2012 and 2017



Source: The Institute for Government: https://www.instituteforgovernment.org.uk/explainers/tax-and-devolution

1 For more information regarding the powers devolved from the UK Government to the Scottish Parliament visit the Scottish Parliament's website: http://www.parliament.scot/visitandlearn/12506.aspx

As Figure 1 shows, there is no plan for the devolution of the power over corporate taxation to Scotland in the foreseeable future. Such a power has been denied to Scotland on the basis that it would create a 'race to the bottom' between Westminster and Holyrood, which in their attempt to lure businesses with lower tax rates would end up with lower overall tax receipts.[2] It must be noted that the same does not seem to apply to Northern Ireland, as the plans for devolving the power over corporate taxation were already announced in 2015.[3]

Whether the unwillingness of the UK's government, to devolve corporate tax powers to Scotland, is something connected with the independence movement is open for discussion. However, since corporate taxation is traditionally linked with a country's sovereignty, the sovereignty of a state is not complete without the power over taxation. This explains, to some extent, why taxation is usually centralised or a responsibility of the central government.

Nevertheless, it must be noted that the British tax system is exceptionally centralised by international standards: little actual discretionary power is located anywhere outside central government.[4] As Figure 2 shows, even after the enactment of the tax devolution measures, the UK's central government is responsible for the most of the revenue generated by taxes. As a matter of fact, very few central governments, of OECD countries, generated more than the 75.7% of total tax revenue generated by the UK's. The average for similar countries is 63.5%; for example the central governments of Italy and France generated 54.4% and 33.4% respectively.[5]

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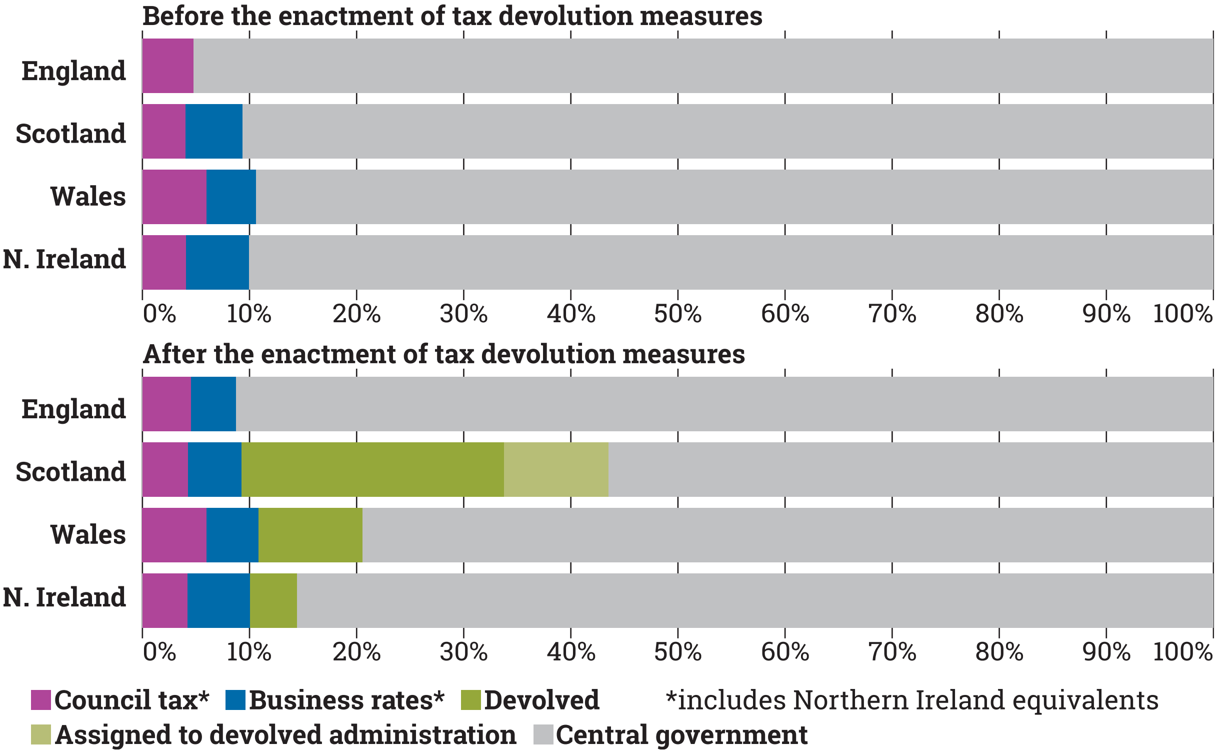
2 The Telegraph (2014), David Cameron Rejects Giving Scotland Corporation Tax: https://www.telegraph.co.uk/news/politics/david-cameron/11271860/David-Cameron-rejects-giving-Scotland-corporation-tax.html

3 Parliament UK (2018), Corporation Tax in Northern Ireland: https://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN07078#fullreport

4 Alt J. Et al (2008), The Political Economy of Tax Policy, p. 1210: https://www.ifs.org.uk/uploads/mirrleesreview/dimensions/ch13.pdf

5 OECD (2018), Revenue Statistics 2018: Tax Revenue Trends in the OECD, p. 13: https://www.oecd.org/tax/tax-policy/revenue-statistics-highlights-brochure.pdf

Figure 2: breakdown of tax revenue by uk nation



Source: The Institute for Government: https://www.instituteforgovernment.org.uk/explainers/tax-and-devolution

Corporate tax rate and competitiveness

Corporation tax is a revenue-raising tax, but it is also employed in order to promote the competitiveness of businesses, with increased revenue being the end goal. As Reuven Avi-Yonah, director of International Tax LLM program at the University of Michigan, says, regulation is a legitimate role of taxation and in some instances taxation is the most effective way to achieve a specific regulatory goal.[6] For example, similar to employing taxation to decrease greenhouse gas emissions, corporate tax is employed to increase competitiveness through the creation of new jobs. As Theresa May, the UK's Prime Minister, stated recently: 'We will encourage businesses to grow and create jobs by continuing to cut corporation tax, because that is how to raise more money, not less.'[7]

This announcement is in line with the report published by the UK government, in March 2016, in which the corporate tax rate will be decreased by a further 1%, from 1 April 2020, to 17%.[8] This is an additional cut on top of the previously announced main rate cuts, which reduced the CT main rate to 18%. Currently, 2019, the UK corporate tax rate is 19%. It is the lowest among the G20 countries and significantly

6 Avi-Yonah R. (2010), 'Taxation As Regulation: Carbon Tax, Health Care Tax, Bank Tax And Other Regulatory Taxes,' Public Law and Legal Theory Working Papers Series: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1664045

7 Financial Times (2017), Theresa May Pledges to Push on with Cuts to Corporation Tax: https://www.ft.com/content/2F7579f124-5742-11e7-9fed-c19e2700005f

8 HM Revenue & Customs (2016), Corporation Tax to 17% in 2020: https://www.gov.uk/government/publications/corporation-tax-to-17-in-2020

below the OECD average (Figure 3). This, in a rather ironical way, means that the UK is actually leading the corporation tax race to the bottom. As May said in an attempt to attract foreign businesses in post-Brexit Britain: 'Whatever your business, investing in a post-Brexit Britain will give you the lowest rate of corporation tax in the G20.'[9]

However, the tax reforms and in particular the further cuts in corporate tax have not been welcomed by many tax experts in the UK. The main point raised is whether this further cut would actually result in an increase in competitiveness, considering the fact that the UK already has a very low rate.[10] For instance, according to a survey by the financial services and accountancy firm PricewaterhouseCoopers (PwC), businesses in the UK think that 'the rate of corporation tax is not the be all and end all. While some participants supported a lower rate, others felt the rate was sufficiently competitive and a further reduction would not help build more trust between business and the public.'[11] Meanwhile, according to the same report, 71% of businesses surveyed believe the corporate tax should either stay at the current levels or at least to not progress beyond the 17%. Furthermore, Bill Dodwell, head of tax policy at the financial auditing and advisory services firm Deloitte, said that: 'Business welcomed the drop to 20 per cent. Nobody seems to welcome the cut to 17 per cent.'[12]

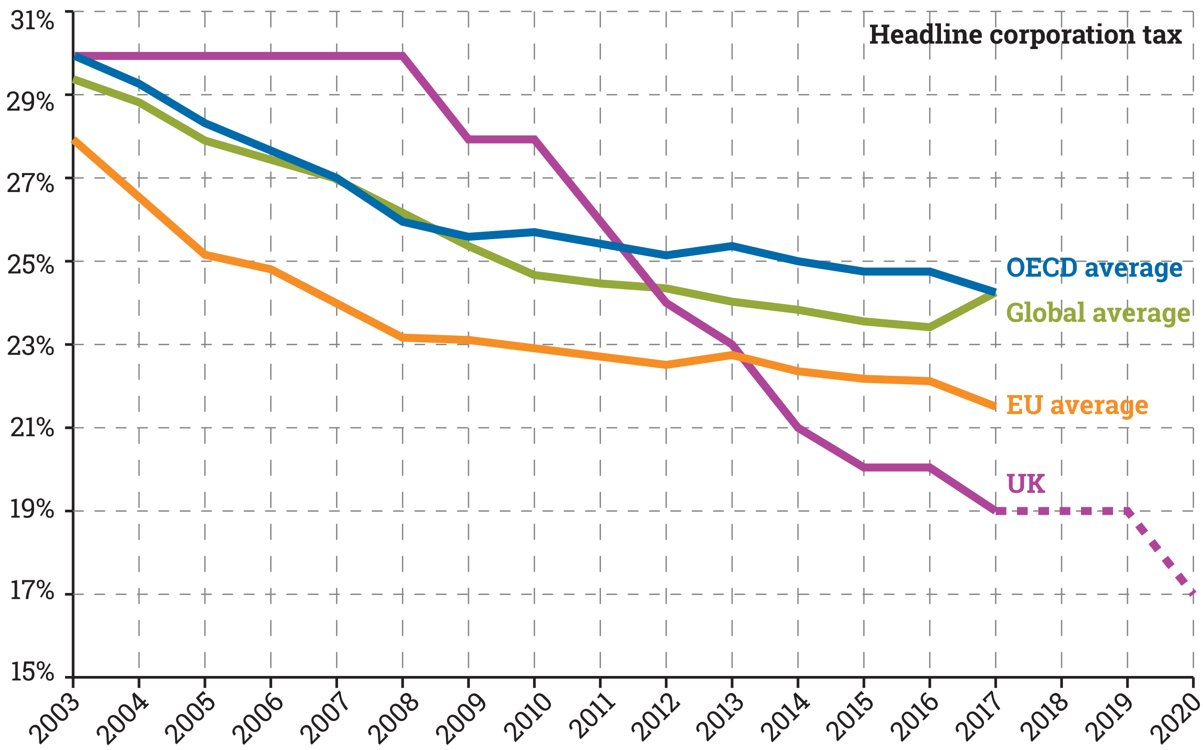
9 Politico (2018), Theresa May Pledges Lowest Business Tax Rate in G20 post Brexit: https://www.politico.eu/article/theresa-may-pledges-lowest-business-tax-rate-in-g20-post-brexit/

10 Corlett A. (2017), 'A Matter of Tax: Pre-Election Briefing on the Main Parties' Tax Policies,' Resolution Foundation: https://www.resolutionfoundation.org/app/uploads/2017/05/A-matter-of-tax.pdf

11 PwC (2016), Paying for Tomorrow: The Future of UK Tax, p.3: https://www.pwc.co.uk/issues/futuretax/the-future-of-tax---what-do-businesses-think-.html

12 Financial Times (2017), Tax Experts call for 'Rethink' of UK corporation tax in Budget: https://ww.ft.com/content/Fa159deba-cb98-11e7-aa33-c63fdc9b8c6c

Figure 3: UK corporation tax rates 2003-2020.



Source: KPMG, with UK rates for 2017-2020 added. [13]

Thus, it appears that the UK government sees the decrease in corporate tax as a policy that leads to increased competitiveness and eventually to a raise in tax revenues. It employs the 'cuts' then as a strategic response to its quest for economic growth; it uses taxation as a regulatory instrument to promote economic growth through making businesses more competitive. This is to say it considers competitiveness to be the main issue that hinders economic growth and corporate tax cuts as the solution to it. However, as stated previously, not everyone shares this view. For instance, the view of the Scottish government, as this appears in the official website of the Scottish Nationalist Party (SNP), is that it does not support any further cuts in the corporate tax rate.[14]

13 As cited in Corlett A. (2017), p. 8.

14 SNP: https://www.snp.org/policies/pb-what-is-the-snp-policy-on-business-rates-and-taxes/

Conservative politics as the platform of corporate tax cuts policies

This section looks to how the approach of the UK government came about. In particular, it examines briefly the historical approach of Conservative governments with regards to taxation and the economy in general. In relation with that, it identifies neoliberal economics as the theoretical basis that underlies the conservative view on economics and corporate taxation in particular.

Thatcherism and the global trend of falling corporate tax rates

In the most recent UK General Election in 2017 the only party that proposed a further cut in corporate tax rate was the Conservative party. According to the party's manifesto:

> The Conservatives will always be the party that keeps tax as low as possible and spends the proceeds responsibly. It is our firm intention to reduce taxes on Britain's businesses and working families…Corporation Tax is due to fall to seventeen per cent by 2020 – the lowest rate of any developed economy – and we will stick to that plan, because it will help to bring huge investment and many thousands of jobs to the UK.[15]

However, the relevant academic literature traces the current political positioning and approach of the Conservative party back to a specific conservative leader, namely the UK's former Prime Minister (1979-1990) Margaret Thatcher. This is mainly because with Thatcher a new era defined by a new model of politics and economics starts for the UK.

This model or approach to political economy has been either defined after Thatcher's very name, Thatcherism, and has it is based on what is commonly known as neoliberalism. Neoliberalism can be broadly defined as the model of political economy that advocates for 'extensive economic liberalisation and policies that extend the rights and abilities of the private sector over the public sector, specifically the shutting down of state and government power over the economy.'[16]

15 The Conservative and Unionist Party Manifesto (2017), Forward Together: Our Plan for a Prosperous Britain and a Prosperous Future, p. 14: https://www.conservatives.com/manifesto

16 Investopedia: https://www.investopedia.com/terms/n/neoliberalism.asp

Box 1: Thatcherism in brief

Margaret Thatcher (1925–2013) was the United Kingdom's prime minister from 1979 to 1990. Her informal transatlantic alliance with U.S. President Ronald Reagan from 1981 to 1989 played an important role in the promotion of an international neoliberal policy agenda that remains influential today. Her critique of UK social democracy during the 1970s and her adoption of key neoliberal strategies, such as financial deregulation, trade liberalisation, and the privatisation of public goods and services, were popularly labeled "Thatcherism."[17]

The conservative approach to low tax rates is basically founded upon the liberal and then neoliberal principle of keeping state intervention at a minimum level. The prevalence of these ideas have inevitably led to a situation where countries, mainly in the Western world, are competing against each other by setting increasingly lower corporate tax rates. As the economists and corporate tax experts Michael P. Devereux and Simon Loretz observe:

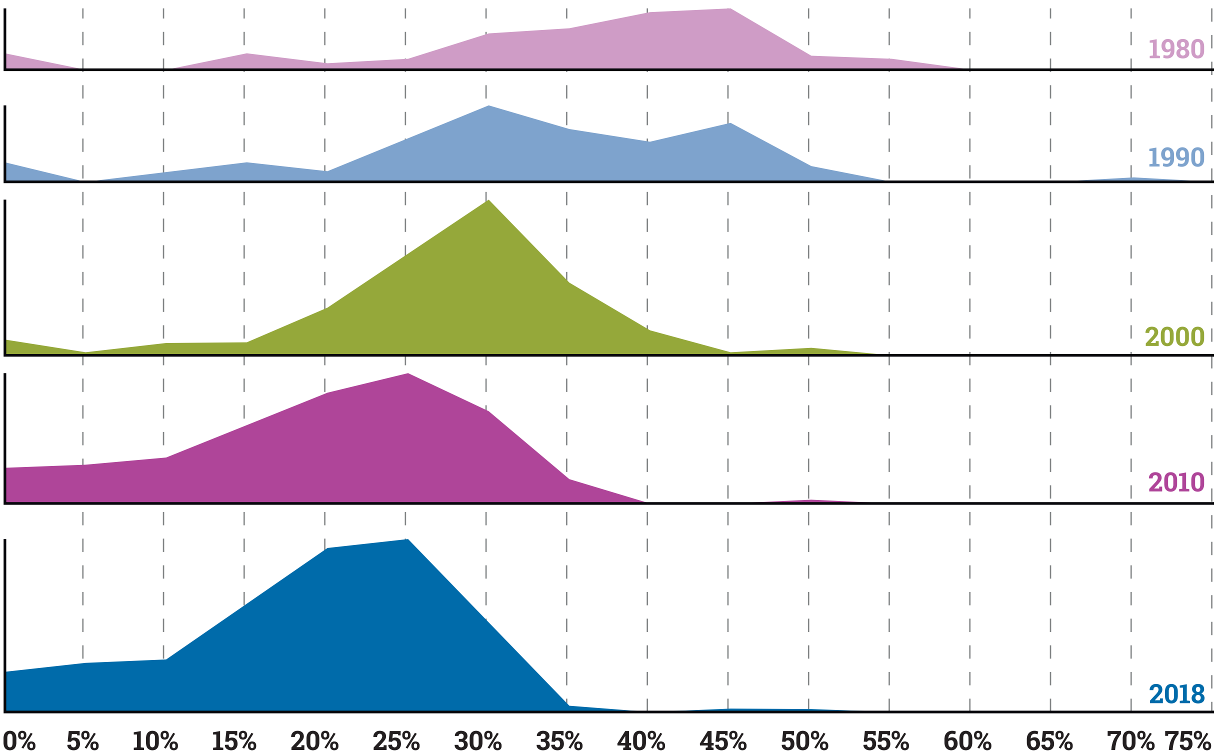
> In the last two decades, policy makers and academics have been increasingly occupied with tax competition. Policy makers have been concerned about a race to the bottom in tax rates on corporate income. The European Union (EU) has set out a code of conduct to combat "harmful tax competition" and the Organisation for Economic Co-operation and Development (OECD) has pursued what it believes to be tax havens in an attempt to inhibit profit shifting, and indirectly to slow tax competition.[18]

17 Scott-Samuel A. et al. (2014), 'The Impact Of Thatcherism On Health And Well-Being In Britain,' International Journal of Health Services 44 (1), pp. 53–71, p. 54.

18 Devereux P. M. and Loretz S. (2013), 'What Do We Know About Corporate Tax Competition?' National Tax Journal 66 (3), pp. 745-774, p. 745.

Lowering corporate tax rates is a trend that is identified by many scholars and as the figures 4 and 5 show it is a global tendency.

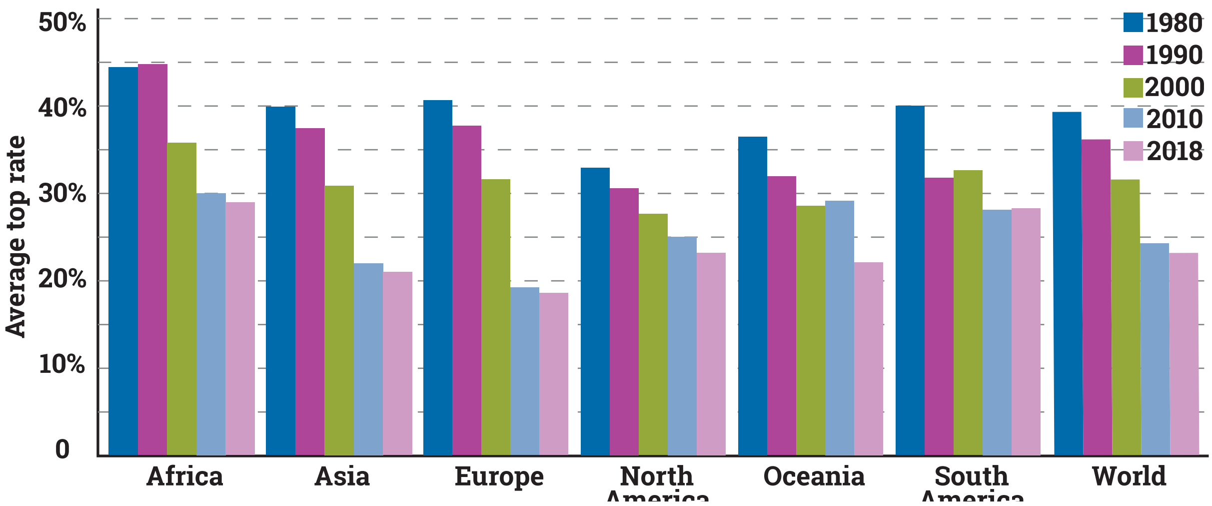
Figure 4: the worldwide distribution of statutory corporate income tax rates, 1980-2018



Source: Bunn D. (2018), 'Corporate Tax Rates Around the World, 2018,' Tax Foundation, Fiscal Fact No 623, p. 9: https://taxfoundation.org/corporate-tax-rates-around-world-2018/.

The data presented in these two figures demonstrates the gradual shift from high corporate tax rates towards lower rates, in line with neoliberal views. It is obvious that there is a world trend, but is there any indication that lower corporate tax rates lead to or assist economic growth?

Figure 5: average top corporate income tax rate by region and decade

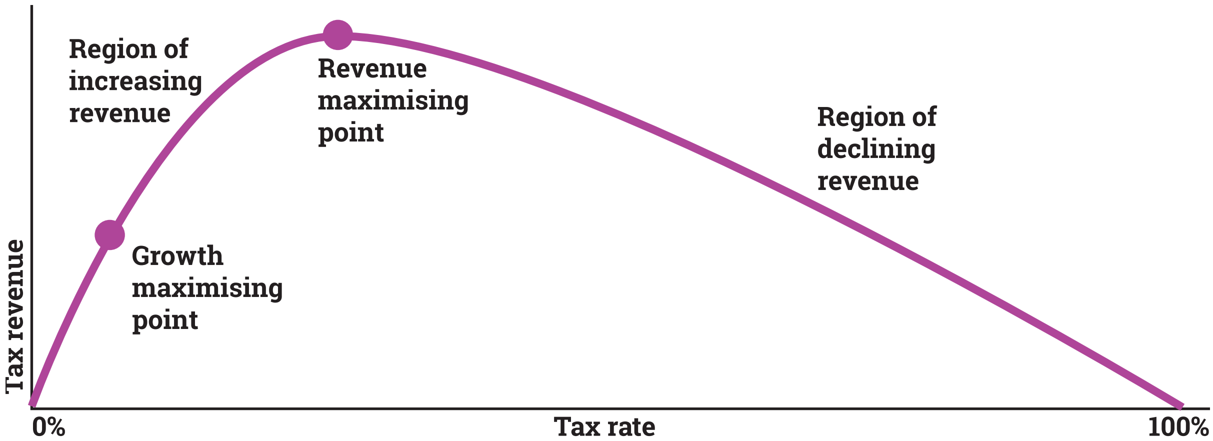


Source: Bunn D. (2018), p. 10.

The economic arguments for lower corporate tax rates

The economic argument currently put forward by the UK government, is that lower corporate tax rates make the UK a more appealing destination for businesses and foreign investment. As a result, they lead to economic growth, which is fuelled by higher revenues for the companies which leads to higher investment and the creation of additional jobs as well as higher earnings for the workers. The theory that supports this belief is that of the economist Arthur Laffer, who argues that there is an optimum rate of taxation that maximises revenues demonstrated in the Laffer curve (Figure 6).

Figure 6: The Laffer Curve



Source: Forbes: https://www.forbes.com/sites/danielmitchell/2012/04/15/the-laffer-curve-shows-that-tax-increases-are-a-very-bad-idea-even-if-they-generate-more-tax-revenue/#3ae4c3be7e1c

According to Laffer, if the government does not tax an economic activity is logically raising no income, but if a government taxes with an 100% rate it also raises no income because it discourages the activity from taking place in the first place. Thus, there is a maximum tax rate the government can set that does not discourage investment and the operation of businesses. Beyond this point the government loses money because it discourages investment and entrepreneurship in general. However, at that point where the governmental revenue from taxation reaches its peak there is no room for growth; growth reaches its peak as well, because every increase in the tax rates beyond this would result into less investment. Subsequently, economic growth is driven by lower tax rates that leave room for or encourage investment.

As the OECD reports:

> Most corporate tax reforms have been driven by the desire to promote competition and avoid tax-induced distortions. Almost all of these tax reforms can be characterised as involving rate cuts and base broadening in order to improve efficiency, while at the same time maintain tax revenues. [19]

19 Johansson A. et al. (2008), 'Tax and Economic Growth,' OECD Tax And Economic Growth Economics Department Working Paper No.620, p. 5: https://www.oecd.org/tax/tax-policy/41000592.pdf

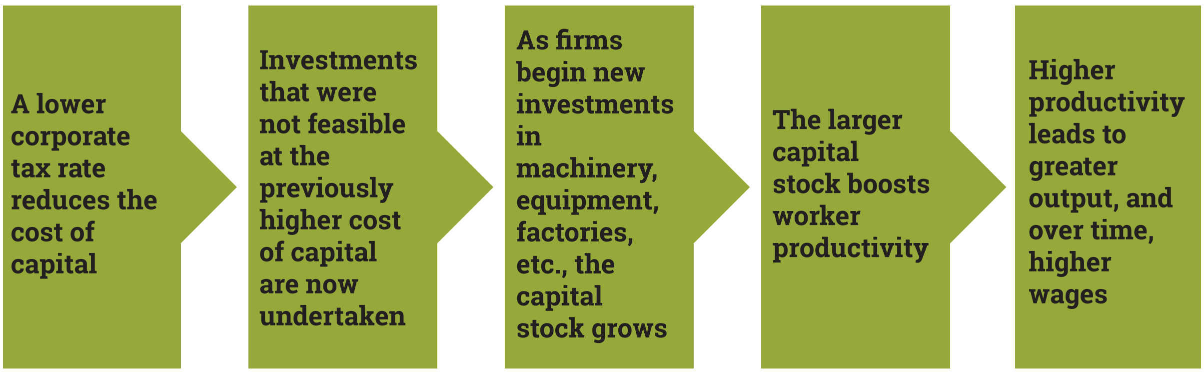
In the same OECD report, corporate tax is identified as the most harmful to economic growth. This is because under the current conditions of globalised trade within which capital mobility is freer than the mobility of individuals, it is easier for a company to invest and relocate. Thus, a higher corporate tax rate may lead companies to relocate to other countries with lower rates or discourage foreign investment in countries with high rates. Meanwhile, it is argued that reducing corporate tax may increase the quantity and quality of investment in a country as well as enhance productivity.[20]

At the same time, a low enough corporate tax rate may have an effect on the very willingness of investors to actually invest because, according to the relevant literature, it provides them with an opportunity to do so; it makes it easier for them to see their investment as profitable. Following the same logic, new investments create new jobs and the inflow of money increases both for the economy as a whole but for workers themselves. According to this understanding, there are two ways in which workers are benefited from higher wages, and from lower corporate tax rates.

The former is related to the relatively higher difficulty for workers to jump from one place to the other and the fact that capital has higher mobility. In this case, a higher corporate tax rate drives businesses to find other locations. This harms the economy as a whole and pushes wages lower or at least does not provide the ground for higher wages. This is in line with a growing body of literature, which argues that high corporate tax rates end up burdening both the company owners and the workers.

A lower corporate tax rate is expected to have the opposite results. This is to say, lower corporate taxes mean that more capital can be invested and boost the size of the economy. This is expected to also increase the productivity; due to investment in innovative technologies, new machinery, educating the workers and so on. In the same sense, it is expected that the increase in productivity, which leads to higher outputs, will in the end push wages higher.

Figure 7: how lower corporate tax rates may raise wages



Source: York E. (2018), 'The Benefits of Cutting the Corporate Income Tax Rate,' Tax Foundation, Fiscal Fact No. 606, p. 4: https://files.taxfoundation.org/20180813165516/The-Benefits-of-Cutting-the-Corporate-Income-Tax_FF606.pdf

20 Johansson A. et al. (2008), p. 9.

With regards to that, the think tank Centre for Policy Studies, co-founded by Thatcher herself, points out that according with the HM Treasury's estimates:

> The tax reductions will increase investment by between 2.5 per cent and 4.5 per cent in the long term (equivalent to £3.6 billion and £6.2 billion) and GDP by between 0.6% and 0.8% (equivalent to between £9.6 billion and £12.2 billion). Lower corporation tax rates will also increase the demand for labour which in turn raises wages and increases consumption. The Treasury estimates that this benefits households by between £405 and £515. [21]

In addition, it highlights the fact that, due to corporation tax cuts, among other things, the UK is one of the most competitive economies in the World. In fact according with the World Economic Forum's latest Global Competitiveness Index the UK is now the 8th most competitive economy in the World, with Germany being the only European country of a similar size to the UK being above it in this list.[22]

Furthermore, the theory that lower corporate tax rates lead to economic growth is also supported by a part of the relevant literature. For example, the study by the tax experts Baranová Veronika and Janíčková Lenka showed that in the case of the EU15 the theoretical assumptions about the negative impact of corporate tax burden to the long-term economic growth were confirmed, in accordance with previous empirical literature.[23] However, there is a large part of literature that argues for the opposite or that emphasises aspects where corporate tax cuts have a negative impact. These aspects are being silenced in the arguments put forward in favour of lower rates and this is what the next section looks into.

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21 Mahoney D. (2017), 'The Case for Corporation Tax Cuts,' Centre for Policy Studies, Briefing Note, p. 3: https://www.cps.org.uk/files/factsheets/original/170307114231-TheCaseforCorporationTaxCuts.pdf

22 Global Competitiveness Index 2017-2018: https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018.

23 Baranová V. and Janíčková L. (2012), 'Taxation of Corporations and Their Impact on Economic Growth: The Case of EU Countries,' Journal of Competitiveness 4 (4,) pp. 96-108, p. 105.

Disregarding income inequality and other aspects of corporate tax cuts in the pursuit of competitiveness

As discussed above, competitiveness over corporate tax rates has increasingly been identified as a global trend by economists; low corporate tax rates are considered as one of the main ways to increase the competitiveness of a country's economy. This is the logic upon which the policy that further cuts corporate tax rates, proposed by the UK government, is based. However, by focusing on this there are other aspects of this approach that have an actual impact on the economy that are being excluded or at least not discussed as much as they should.

There is a weak link between corporate tax cuts and economic growth

To start with, it must be stated that lowering corporate tax rates does not necessarily lead to economic growth, at least not in terms of GDP, which has been the standard measure for the size of a country's economy since 1944.[24] This is in opposition to one of the main assumptions that have led the worldwide trend of corporate tax cuts. For example, a report by the UK Trade Union Congress (TUC) concludes, through the study of data from OECD countries, that the relationship between corporate tax rates and economic growth is weak:

> The linkage between the two as suggested by the resulting correlation coefficient that might reasonably be expected to apply to the UK suggest that over 90% of growth in this range is explained by factors other than tax. In that case cutting tax rates to stimulate growth appears a poor choice of economic policy. [25]

Along the same lines, in a study conducted by the economists Alexander Ljungqvist and Michael Smolyansky, on the US economy, found that 'increases in corporate tax rates are uniformly harmful for workers while corporate tax cuts are ineffectual in boosting economic activity unless implemented during recessions.'[26]

The US is a relevant example of a country that ranks very high in the Global Competitiveness Index, it is currently second only to Switzerland, while it has recently, under Donald Trump, cut its federal/national corporate tax rate by 14%; from 35% to 21%. It must be made clear that the corporate tax rate in the US is the aggregate of the federal rate plus the state rate. This means that it can be as low as 21% in Ohio, where the state rate 0%, and as high as 29.5% in Iowa, where the state rate is 12% but there is a

24 Dickinson E. (2011), GDP: a Brief History: https://foreignpolicy.com/2011/01/03/gdp-a-brief-history/

25 TUC (2011), Corporate Tax Reform and Competitiveness, p. 30: https://www.tuc.org.uk/sites/default/files/corporate_tax_reform_and_competitiveness.pdf

26 Ljungqvist A. and Smolyansky M. (2016). 'To Cut or Not to Cut? On the Impact of Corporate Taxes on Employment and Income,' Finance and Economics Discussion Series 2016-006, p.31.

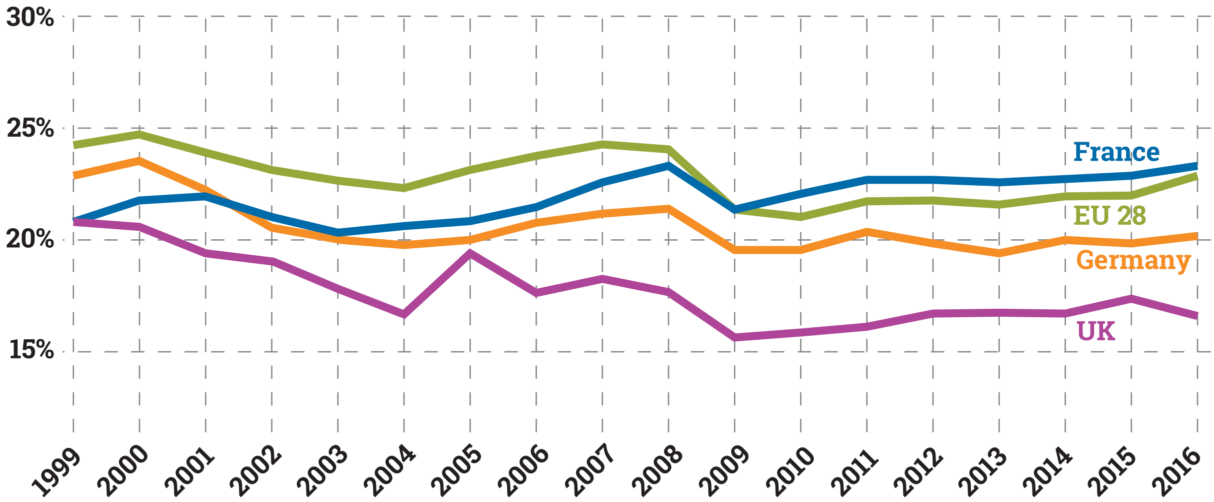
deduction of 2.5% for federal liability.[27] Nevertheless, in any case US's rate is still higher than the UK's rate. This means that competitiveness and economic growth as what necessarily follows the reduction of corporate tax rates should at least be doubted.

Lower corporate tax rates not necessarily increase investment

In addition, there seems to be disregard of the data that doubts the claim that lowering corporate tax rates increases internal investment or attracts foreign investment. For instance, research done in the US has shown that despite the lower rates, instead of reinvesting profits companies have given an increasing portion back to their shareholders; over the past 15 years or so, non-financial corporates have returned money to their shareholders through dividends or equity buybacks equivalent to 75%-80% of pre-tax profits.[28]

Business investment in the UK in 2016 was much lower than that in Germany and France as the following figure (Figure 9) shows. It must be noted that Germany and France have much higher corporate tax rates than the UK. As the Institute for Public Policy Research (IPPR) says, 'though this largely reflects the structure of these economies, with larger manufacturing sectors and stronger business investment conditions, it demonstrates at least the weak correlation of investment and corporation tax rates.[29]

Figure 9: comparing business investment in the uk with other european economies



Source: Eurostat[30]

27 Pomerleau K. (2018), The United States' Corporate Income Tax Rate is Now More in Line with Those Levied by Other Major Nations: https://taxfoundation.org/us-corporate-income-tax-more-competitive/

28 Bandholz H. (2017), Corporate Tax Cuts will Benefit Shareholders not Economic Growth, UniCredit Economics Thinking No. 52, p. 2: https://www.research.unicredit.eu/DocsKey/economics_docs_2017_161858.ashx?M=D&R=52039503

29 IPPR (2018), 'Fair Dues: Rebalancing Business Taxation in the UK,' IPPR Commission on Economic Justice, p. 14: https://www.ippr.org/files/2018-03/cej-income-tax-march18.pdf

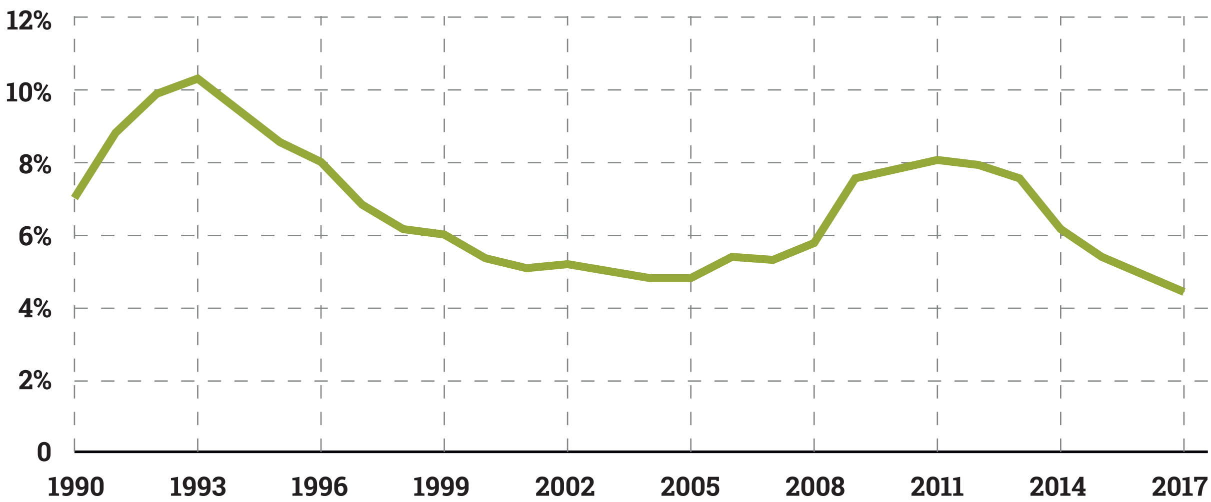
30 As cited in IPPR (2018), p. 15.

The UK, has reduced its statutory corporate tax rate from 30% in 2007 to 19% in 2017.[31] But the UK investment-to-GDP share today is actually lower than it was in 2007. With regards to the claim about foreign direct investment (FDI), a study by the political economist Nathan M. Jensen, an expert in economic development and FDI, finds no relationship between FDI and corporate tax rates. It does so through an empirical assessment of the impact of corporate tax rate changes on FDI inflows into OECD countries. In fact the results of the study are categorical; there is no evidence whatsoever of a relationship corporate tax rate changes and FDI flows, following the employment a number of different tax rate variables, control variables, and estimation techniques for up to 19 OECD countries from 1980 to 2000.[32]

It appears then that representing the policy of corporate tax cuts as a solution to the problem of competitiveness is at least inaccurate The fact that there is no demonstrable relationship between the alleged increased attractiveness of the economy for investment and lower rates is silenced or disregarded. But if there is no additional inflow of investment, then it follows that there should not be any additional jobs, since it is the extra investment that would allegedly create new jobs.

However, it appears that this is not the case. UK's unemployment rate is the lowest it has been in the past 40 years or so, as the Figure 10 shows.

Figure 10: uk unemployment rate (percentage of over-16s not in employment)



Source: McCall C. (2018), London dominates UK jobs growth over past decade: https://www.bbc.co.uk/news/uk-england-46288515

The low percentage of unemployment, which may be attributed also to the fact that the UK economy has recovered from the 2008 crisis, has been used by the UK government as a proof that its policies are working. In fact, as BBC reports, it has been characterised by Liz Truss, the Chief Secretary to the Treasury, as a 'real jobs miracle in this country.' However, it must be noted that the vast majority of the new jobs have been created in

31 Bandholz H. (2017), p. 4.

32 Jensen M. N. (2012), 'Fiscal Policy and the Firm: Do Low Corporate Tax Rates Attract Multinational Corporations?' Comparative Political Studies 45(8), pp. 1004–1026, p. 1019.

London and they were mostly service jobs. As Troy Wilson, director of the Institute of Employment Studies, said, 'the UK is even more of a services-based economy now than it was 10 years ago. Regions which have been more reliant upon non-service sectors - such as manufacturing or construction - have done relatively less well.'[33] Moreover, according with the same BBC report, Christopher Warhurst, director of the Warwick Institute for Employment Research, said that most of the jobs created, driving the decrease in the percentage of unemployment, are low-skilled, low-wage jobs.

Negative relationship between low corporate tax and income inequality

Increasing income inequality seems to be the main issue the corporate tax cuts policy and the rhetoric that accompanies it silence. As stated previously, in the case of the US, the vast majority of the earnings from the lower tax rates have been payed out to shareholders mainly in the form of dividends. In other words, a group of arguably wealthy individuals received additional income. In relation to that point, from a UK perspective, the IPPR report notes that cutting corporation tax while raising national insurance contributions has almost certainly led to greater inequality.'[34] Furthermore, there are recent studies that show that there is an empirical link between corporate tax cuts and income inequality. For instance, to summarise the findings of a recent study published by the Harvard Business School:

> Corporate tax cuts increase top income inequality; a state corporate tax cut of 0.5 percentage point would explain about 12.4% of the average rise in the share of income accruing to the top 1% between 1990 and 2010. The size of the effect is greater than that implied by a mechanical increase in after-tax income to business owners. This suggests that workers are not benefiting from state corporate tax cuts. Top income taxpayers benefit from the returns of additional investment as well as by shifting income from salary and wages to capital income. [35]

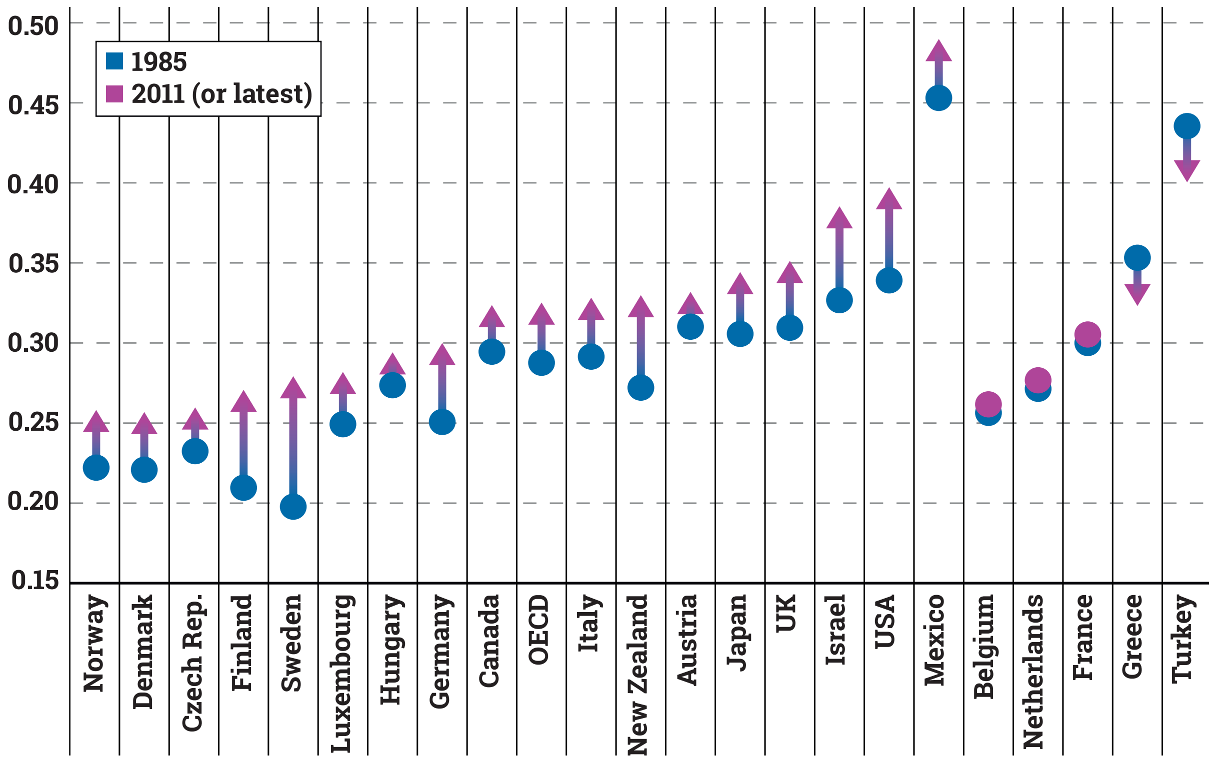
OECD's study found that inequality has a negative impact on economic growth. In particular, using the Gini coefficient, a synthetic indicator that takes into account the whole distribution of income, which is a widely-used standard measure of inequality and ranges from zero (when everybody has identical incomes) to one (when all income goes to only one person) found that income inequality rose in the vast majority of OECD countries between 1985 and 2012 (Figure 11).

33 McCall C. (2018), London dominates UK jobs growth over past decade: https://www.bbc.co.uk/news/uk-england-46288515

34 IPPR (2018), p. 17.

35 Nallareddy S. et al. (2018), 'Corporate Tax Cuts Increase Income Inequality,' Harvard Business School Working Paper 18-101, p. 12: https://www.hbs.edu/faculty/Publication%20Files/18-101%20Rouen%20Corporate%20Tax%20Cuts_0a4626be-774c-4b9a-8f96-d27e5f317aad.pdf

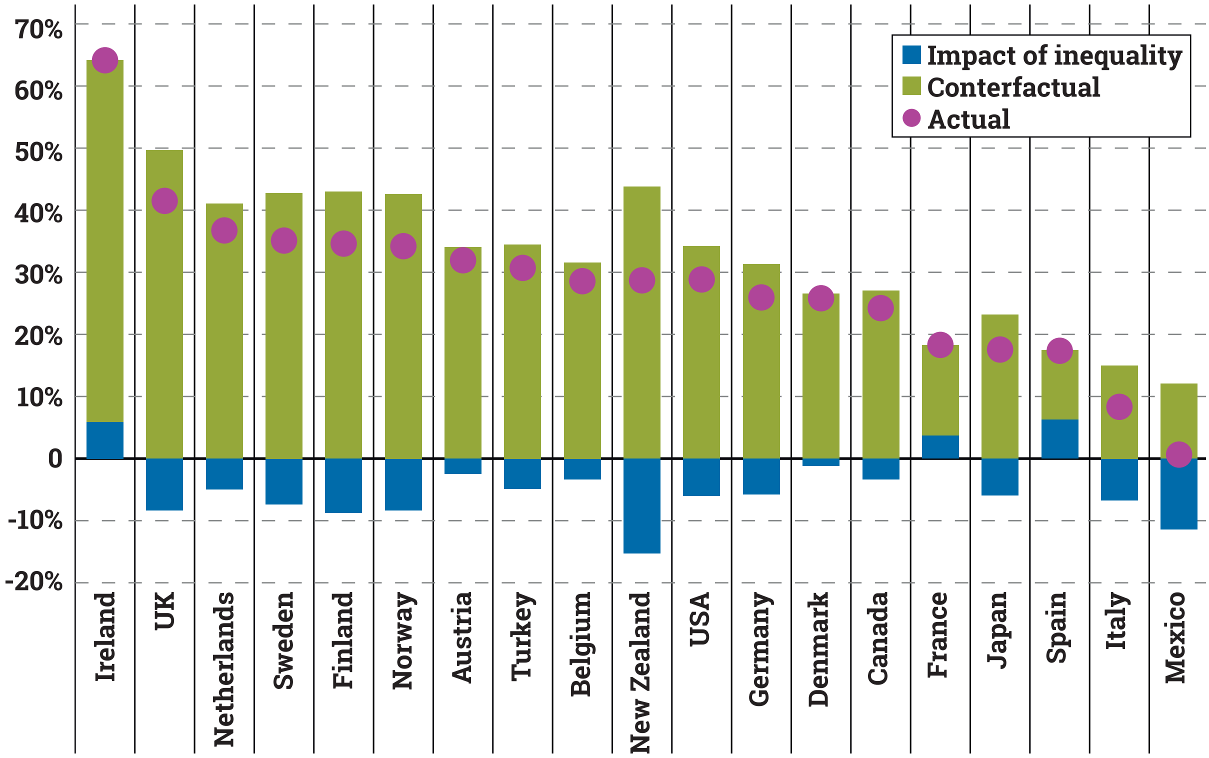
Figure 11: increase of income inequality in most of the OECD countries (1985-2012)



Source: Cingano F. (2014), Trends in Income Inequality and its Impact on Economic Growth", OECD Social, Employment and Migration Working Papers, No. 163, p. 9: http://dx.doi.org/10.1787/5jxrjncwxv6j-en

Furthermore, the report estimates the rate of economic growth for OECD countries, between 1990 and 2010, if income inequality had not increased. According to this estimation the growth rate of the UK's economy would have been more than one fifth higher, as Figure 12 shows. In contrast, with the general findings of the report, greater equality helped increase GDP per capita in Spain, France and Ireland prior to the crisis.

Figure 12: estimated consequences of changes in inequality on cumulative per capita GDP growth (1990-2010)



Source: Cingano F. (2014), p. 18.

When it comes to understanding how income inequality affects economic growth in a negative manner, there are a few simple and logical explanations. For example, in an economy where income inequality increases, people who earn low wages are not able to afford higher education and thus the economy ends up with proportionally more low-skilled workers. Low-income workers have a decreasing buying power and thus consume less. Most importantly though, disregarding income inequality is similar to disregarding a fundamental factor that may lead to lower productivity and thus have a negative impact on economic growth.

It must be stated also that it is only logical that workers who are not getting what can be seen as their fair share in growth in terms of higher wages will be discouraged and thus less productive. As, the widely known as the 'father of economics,' Adam Smith observes in his magnum opus, Wealth of Nations:

> Where wages are high, accordingly, we shall always find the workmen more active, diligent, and expeditious than where they are low: in England, for example, than in Scotland; in the neighbourhood of great towns than in remote country places.[36]

36 Smith A. (1776), Wealth of Nations, Book 1, Chapter 8, 44: http://geolib.com/smith.adam/won1-08.html

Lower productivity as the main indirect effect of the corporate tax cuts policy

The policy of cutting corporate tax cuts further seems to be at least controversial; from the theoretical foundations of it to the very end it pursues - competitiveness. The data and research that exists demonstrates that there are no clear and established links between corporate tax rates and competitiveness or economic growth for that matter. In addition, it is apparent that there is a negative relationship between corporate tax rates and income inequality; lowering the rates leads to more inequality.

Lower corporate tax rates mean less revenues

This is an aspect of the policy that does not seem to be looked upon or problematised adequately by the UK government. If increased income inequality is not reason enough for a government to abandon this policy, it certainly should be in the view of this report, then the fact that it affects productivity and thus economic growth should be. This section, starts by looking briefly into the various effects the further corporate tax cuts are estimated to have on the UK economy and then it focuses on the issue of productivity in the UK as a whole and in Scotland.

To start with, according to a report by the Institute for Fiscal Studies (IFS):

> Cuts to corporation tax rates announced between 2010 and 2016 are estimated to reduce revenues by at least £16.5 billion a year in the short to medium run. Accounting for measures that raise revenue, including anti-avoidance measures, onshore corporate tax policies over this period reduce revenues by an estimated £12.4 billion a year.[37]

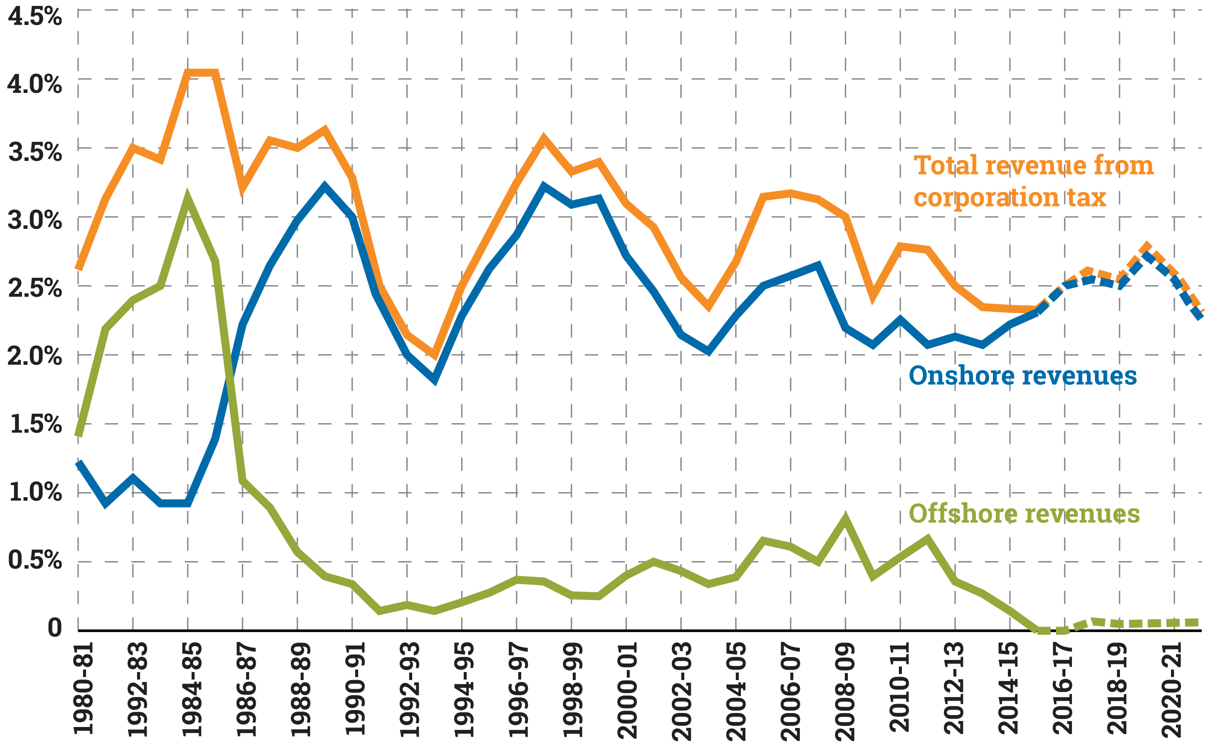
In particular, as the Figure 13 shows, the UK government's revenue from corporate taxation is forecasted to be 2.3% of national income by 2020-21, which is lower than what it was in 2010, when the rate was 28%. However, it must be noted that despite the fact that the rate has decreased from 52% in 1981 to 28% in 2008, there was no strong downward trend. According with the IFS's report this is mainly due to an increase in the size and profitability of the corporate sector, and to some extent to a broadening of the tax base.

It is also worth noting that corporate tax revenue increases in 2016-17. This may be attributed, as stated in the previous section, to the decrease in corporate tax rates from 20% to 19%. However, there have been a number of issues that have affected tax revenues in a positive way and probably these are the underlying causes of the increase in revenue more so than the decrease in the tax rate. For instance, as stated previously in this report, the profits of the companies have increased, as a result of the recovery

37 Miller H. (2017), 'What's been happening to corporation tax?' IFS Briefing Note BN206, p.1: https://www.ifs.org.uk/publications/9207

of the economy from the 2008 crisis. Also, measures to reduce tax avoidance have had a positive impact alongside the trading losses policy, which have probably resulted in more profits appearing in the short-run; through carrying losses to future accounting periods.[38]

Figure 13: corporation tax receipts as a share of national income

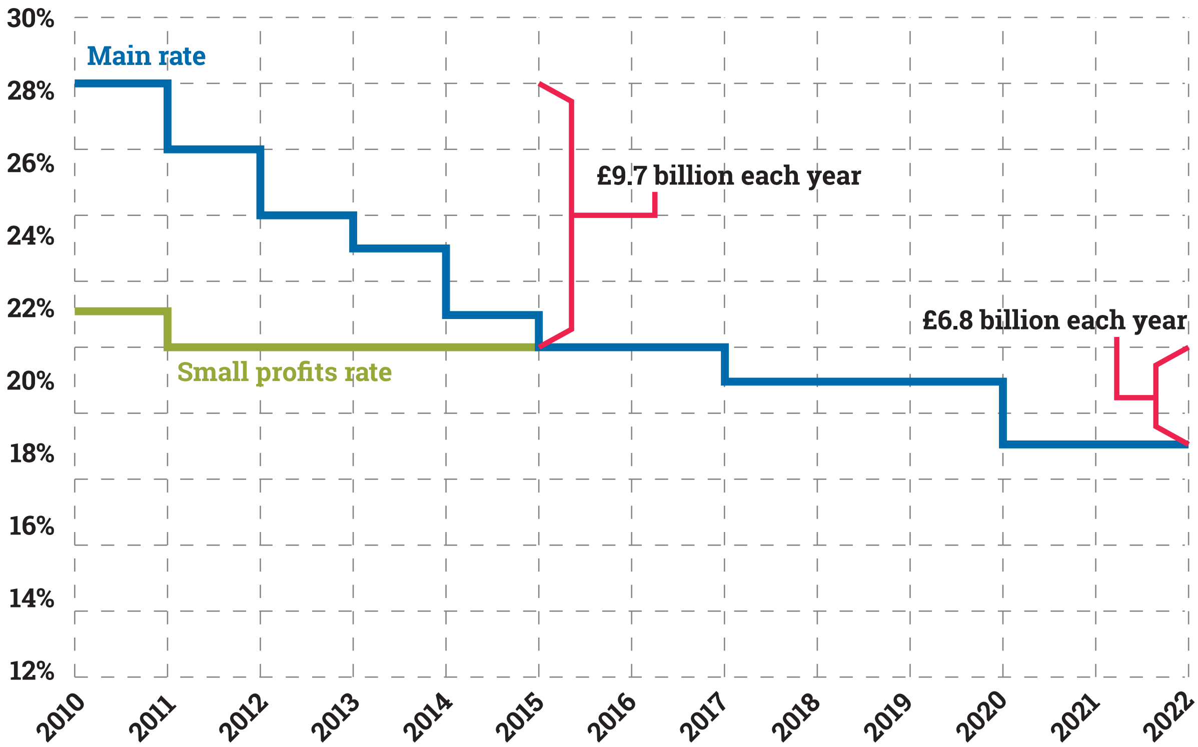


Source: Miller H. (2017), p. 2.

Furthermore, based on official policy costings the further cut in the corporate tax rates, combined with the decrease in the small profits rate, costs £16.5 billion each year in 2017–18 terms.

38 HMRC (2018), Corporation Tax: Trading Losses: https://www.gov.uk/guidance/corporation-tax-calculating-and-claiming-a-loss

Figure 14: rates of UK corporation tax and revenue cost of rate cuts in 2017–18 terms



Source: Miller H. (2017), p. 5.

Considering that Scotland's revenues from corporate taxation are estimated to be approximately 7% of the total revenues (excluding offshore revenues), it would be accurate to say that the further cuts could cost Scotland £1.15 billion/year respectively.[39]

More income inequality means less productivity

This report highlighted the fact that there is a negative relationship between corporate tax rates and income inequality. In addition, it has been stated that income inequality is related to productivity; increased income inequality leads to lower productivity. With regards to that, a recent empirical, cross-country study by the developmental economist William R. DiPietro found that a key determinant of productivity growth is the degree of income inequality in society: 'productivity growth is negatively related to income inequality. Whether income inequality is used alone in a regression equation, or adjusted for various control variables, income inequality is negative and statistically significant.'[40]

Productivity, in economics, is a measure of output per unit of input, such as labor,

39 HMRC (2018), A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland, p. 22: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/746149/Disaggregated_tax_and_NICs_receipts_-_methodological_note.pdf

40 DiPietro R. W. (2014), 'Productivity Growth and Income Inequality,' Journal of Economics and Development Studies 2 (3), pp. 1-8, p. 7.

capital or any other resource. It is typically calculated for the economy as a whole, as a ratio of GDP to hours worked. Productivity is a very important indicator for an economy's competitiveness as well as of its ability to grow. This is because, in reality, it measures the ability of a country to better its standard of living through producing more goods and services per worker. Meanwhile, it can boost the competitiveness of businesses by making it possible to provide better wages, attract skilled personnel and provide higher rates of investment. As the distinguished economist Paul Krugman says:

> Productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.[41]

According to the UK's Office of National Statistics (ONS), 'labour productivity in Quarter 3 (July to Sept) 2018 grew by 0.2% compared with the same quarter a year ago; this is around one-tenth of the average rate observed pre-2008 when the UK's "productivity puzzle" emerged.'[42] This means that the issue with UK's productivity emerged 10 years ago and it remains unsolved. Many if not all advanced economies have experienced decrease in productivity growth since the 2008 crisis. However, the UK's slowdown has been more dramatic than any leading western economy, as the annual productivity growth has plummeted from average annual rates of about 2.3% to 0.4% in the past decade.[43]

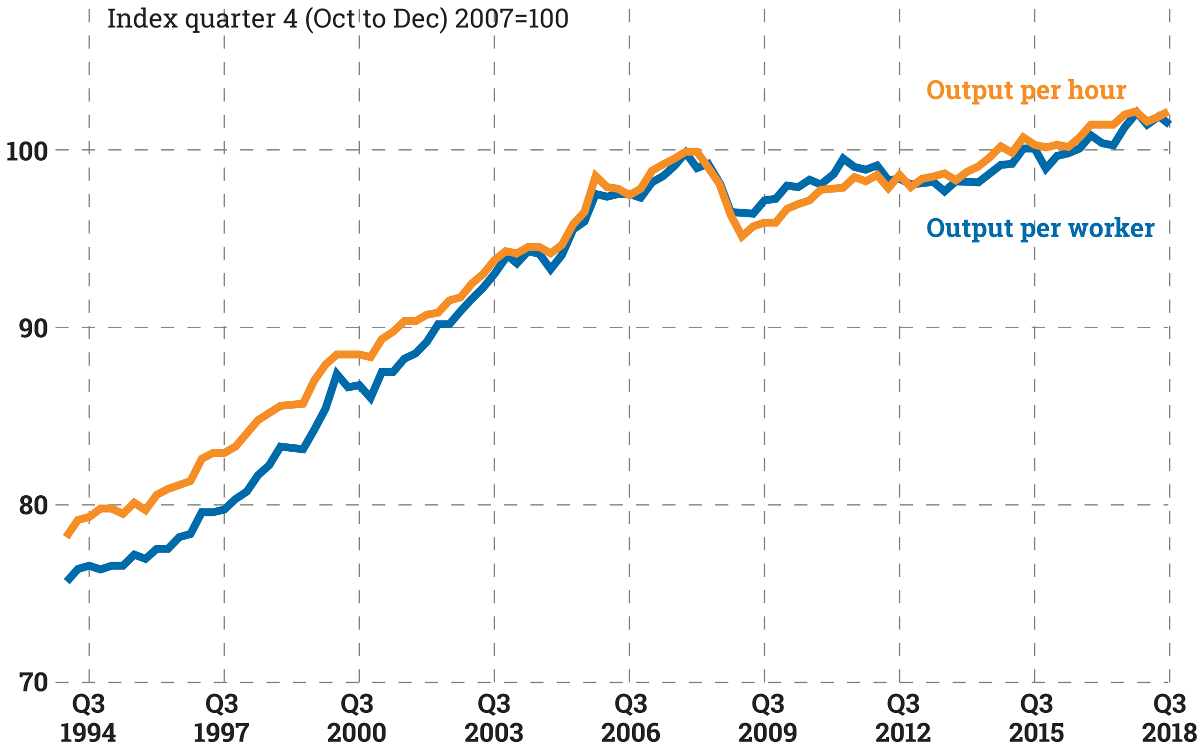
The stagnation of UK's productivity growth is shown in Figure 15. At that same time the situation, with regards to productivity, is almost the same in Scotland with productivity growing by approximately 0.3% per year from 2004 to 2017. This is apparent in Figure 16, which shows the stagnation in productivity growth in Scotland starting in 2004, in comparison with 2008 for the UK as a whole.

41 Krugman P. (1992), The Age of Diminished Expectations: US Economic Policy in the 1980s, (Cambridge: MIT Press), p. 9.

42 ONS (2018), Productivity economic commentary: July to September 2018: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/articles/ukproductivityintroduction/julytoseptember2018

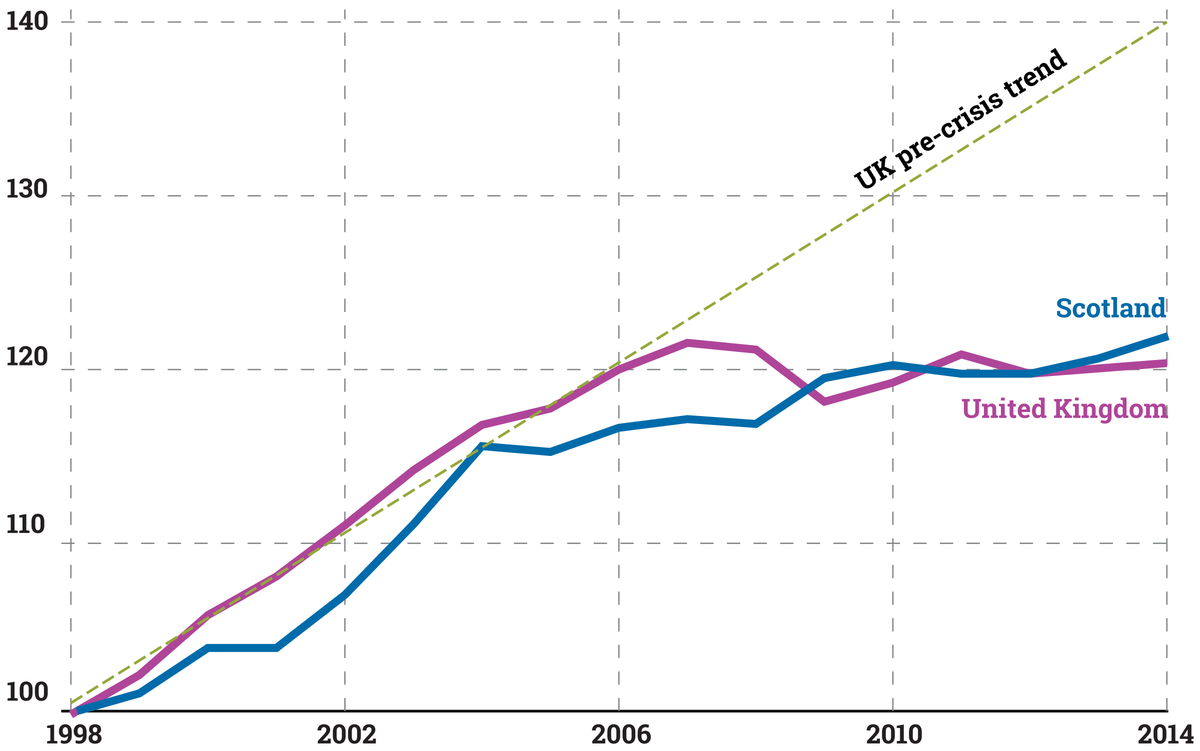
43 Giles C. (2018), 'Britain's Productivity Crisis in Eight Charts,' Financial Times Series: UK Labour Productivity Crisis: https://www.ft.com/content/b9fd12e6-9edf-11e8-85da-eeb7a9ce36e4

Figure 15: productivity growth in the UK (1994-2018)



Source: ONS: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/articles/ukproductivityintroduction/julytoseptember2018

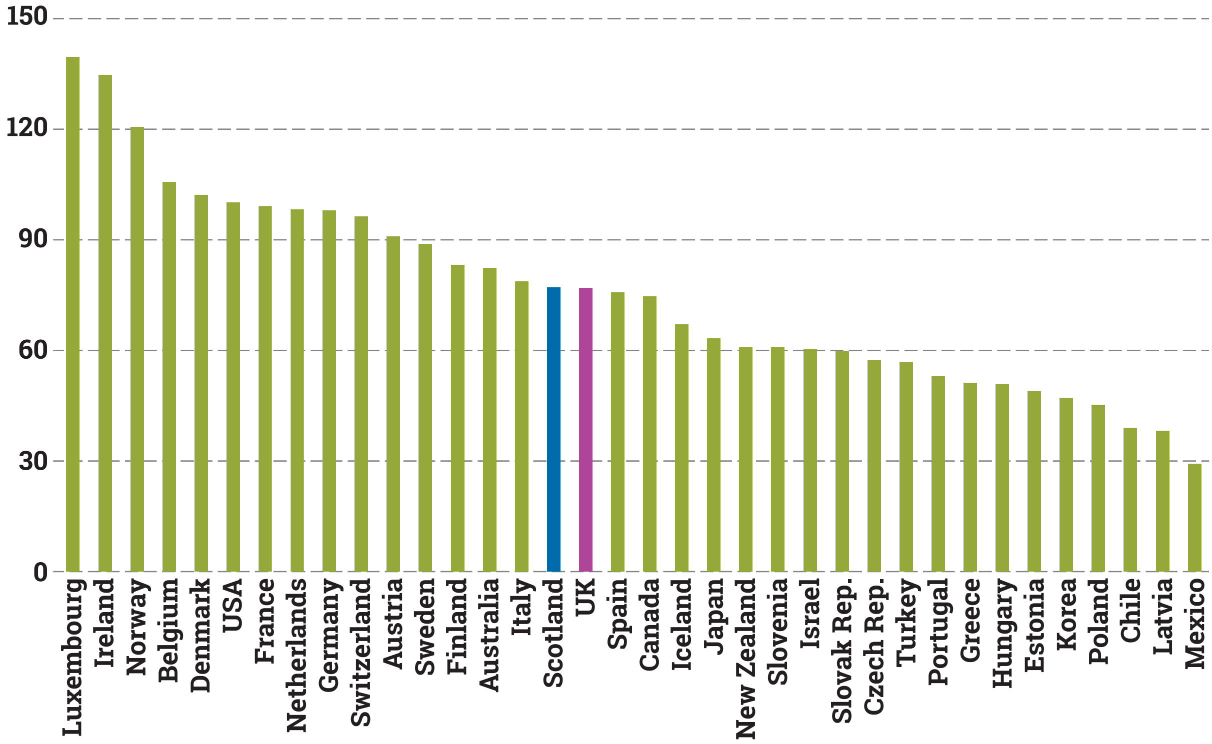
Figure 16: Scottish and UK Productivity (1998-2014)



Source: The David Hume Institute: Wealth of Nation: Scotland's Productivity Challenge, p. 9: https://static1.squarespace.com/static/59b82ed532601e01a494df34/t/5b90c890c2241b85ea99ace7/1536215190323/Wealth%2Bof%2Bthe%2BNation%2B060918.pdf

Meanwhile, in comparison with other OECD countries Scotland's position has been improved; it would ranked in the second quartile among the OECD countries in 2015 (Figure 17). In 2007 Scotland was in the third quartile and it aims to be in the first by 2017. There is currently no available data for 2017.

Figure 17: labour productivity among OECD countries in 2015

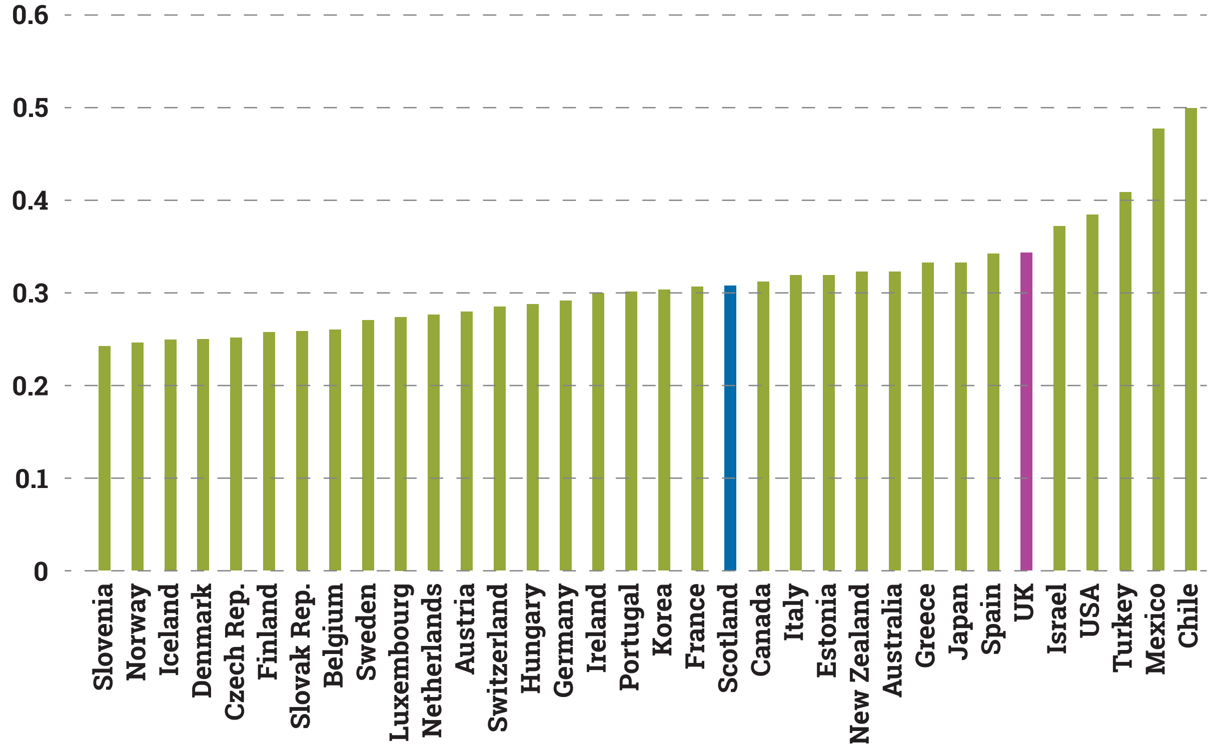


Source: O'Connor A. & Liddell G. (2017), 'Scotland's economic performance - comparative research,' The Scottish Parliament, SPICe Briefing, p. 24: https://sp-bpr-en-prod-cdnep.azureedge.net/published/2017/12/7/Scotland-s-economic-performance---comparative-research/SB%2017-86.pdf

At the same time Scotland would ranked 20th among OECD countries in terms of income inequality, while the UK ranked 29th out of the 34 countries in 2015 (Figure 18). Scottish government's report points out that this seemingly unusual as developed countries of similar size to that of Scotland, such as Norway, Denmark, Sweden, and, to a lesser extent, Ireland, all experiencing significantly lower levels of income inequality than Scotland.[44] Scotland would rank 21st out of 36 countries in productivity growth and 20th out of 34 countries in income inequality.

44 O'Connor A. & Liddell G. (2017), p. 32.

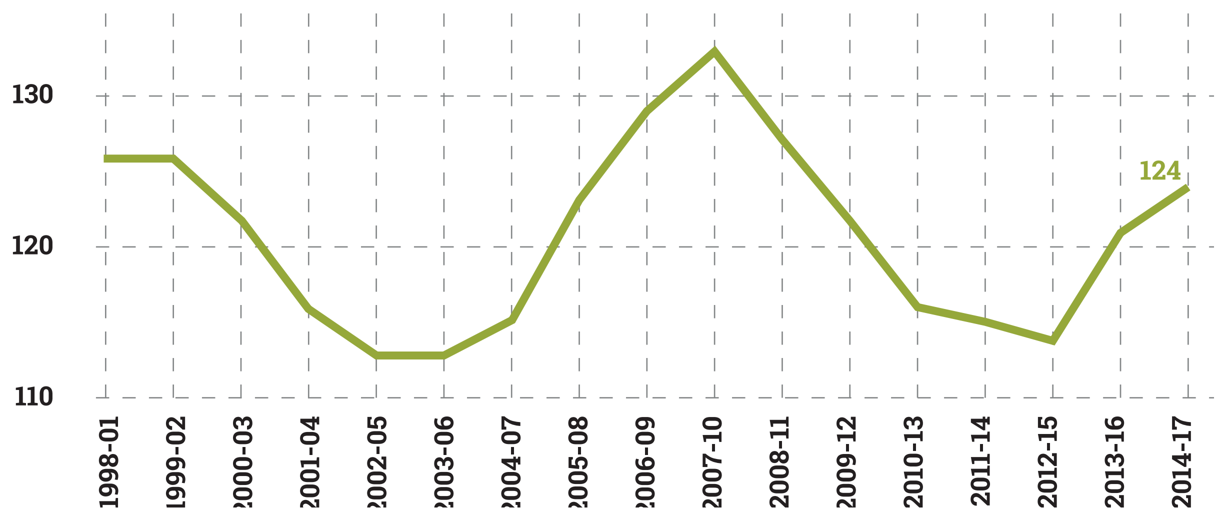
Figure 18: income inequality (Gini coefficient) in the OECD in 2015



Source: O'Connor A. & Liddell G. (2017), p. 32.

Meanwhile, using the Palma ratio, an alternative measure of income inequality, it appears that there is an increasing trend of income inequality in Scotland. The Palma ratio is used by the Scottish government, as well as internationally, to monitor the extent of inequality between those at the top of the income distribution and those at the bottom. As the following figure (Figure 19) shows that 'the top ten percent of the population had 24% more income in 2014-17 than the bottom forty percent combined.'[45]

Figure 19: Palma measure of inequality in Scotland

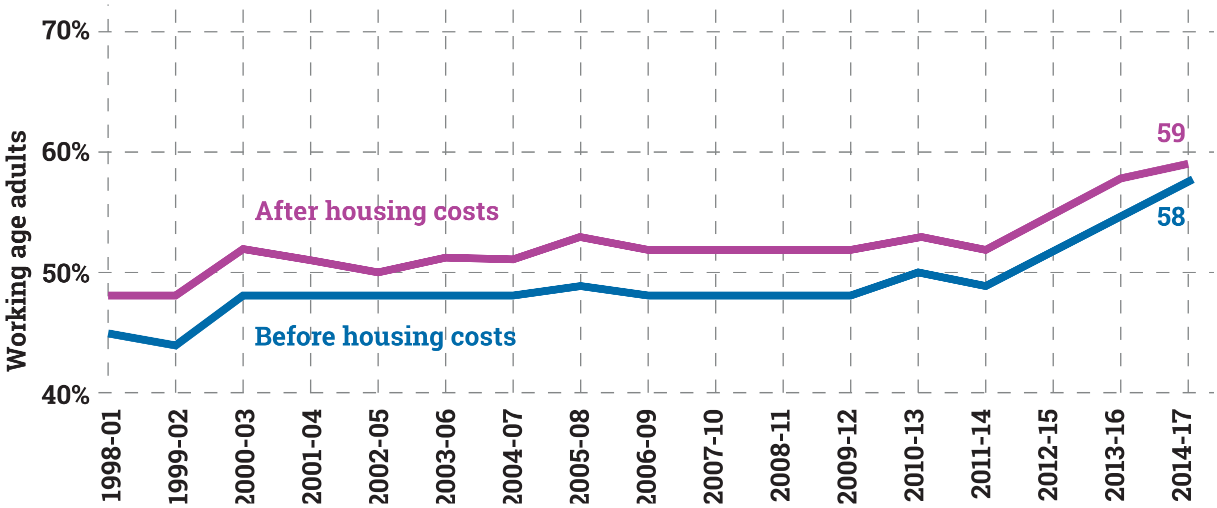


Source: O'Connor A. & Liddell G. (2017), p. 8.

45 O'Connor A. & Liddell G. (2017), p. 8.

At the same time, in-work poverty for working-age adults is increasing in Scotland since the 2011-14 period, as Figure 20 shows. In particular, in the 2014-17 period 58% of working-age adults in relative poverty before housing costs were living in working households. After housing costs, this was 59% of working-age adults. It must clarified that 'in-work poverty refers to people living in households where at least one member of the household is in either full or part-time paid work, but where the household income is below the relative poverty threshold.'[46]

Figure 20: in-work poverty for working-age adults in Scotland



Source: O'Connor A. & Liddell G. (2017), p. 13.

46 O'Connor A. & Liddell G. (2017), p. 13.

Incentivising Scottish corporate tax rate to decrease income inequality and boost productivity growth

Based on what has been discussed, it is fair to say that there is no need for further corporate tax cuts. It is a policy that in the long-run reduces tax revenues and it does not even seem to be increasing either the competitiveness of UK economy or investment. As Torsten Bell, director of the Resolution Foundation think tank, says, 'there's not even an argument for these tax cuts from a competitiveness point of view. When you're already winning the race to the bottom you don't need to speed up.'[47]

Nevertheless, the literature that exists about the link between corporate tax rates and competitiveness is inconclusive; there are studies that support the idea and other that reject it completely. This creates a vague framework for policy-making. It is unclear why governments choose to follow the path of corporate tax cuts, since the evidence in favour is, at least, not strong enough. There is the possibility that policy-makers are influenced by lobbying groups. This is due to the very nature of corporate tax being very complex and not something easily understandable by the public.[48]

It may be because, a complex mechanism such as corporate tax can be easier to manipulate. This means it is easier for a government to utilise it as an explanation for any positive change in the economy and take credit for it through convincing a largely ignorant public opinion of the merits of its policies. Nonetheless, it may simply be because governments are themselves convinced that this is how they can drive competitiveness or the fact that they ascribe to neoliberal understandings of the economy. This seems to be the case with the UK government that is openly praising the neoliberal model of political economy.

Corporate tax powers for a purpose

Within this framework, set by the UK government, the Scottish government is limited. It is limited by definition, since it has no power over corporate taxation, but it is also constrained by the very approach adopted by the UK government. For example, it seems really difficult for Scottish government, if it had the power, to drastically raise the corporate tax rate, when the rate of the rest of the UK is already very low. If there is a link between corporate tax rates and competitiveness this would arguably be more apparent in cases of neighbouring countries where business relocation is easier. It would be logical to assume that these circumstances would also constrain the ability of an independent Scottish government to come up with policies regarding taxation, at least throughout the transitional period towards independence.[49]

47 Partington R. (2019), UK corporation tax cut to cost billions more than thought, The Guardian: https://www.theguardian.com/politics/2019/jan/28/uk-corporation-tax-cut-to-cost-billions-more-than-thought?fbclid=I-wAR3QyM1_QXwmf7lbO92Fbhogi9Og7zg9Kg4xbVAj7dhNA5USoT0Uh4YgyRQ

48 Alt J. Et al (2008), p. 1245.

49 Adam S. et al. (2014), 'Taxing an Independent Scotland,' Oxford Review of Economic Policy 30 (2), pp. 325–345, p. 339.

This report suggests that the Scottish government should ask again for power over corporate taxation. This demand should be made in relation to the devolution of this very power to the government of Northern Ireland. It should emphasise the fact that this puts Northern Ireland into a favourable position or provides it with the competitive advantage of having the power to set its own rates. If power over corporate tax rates is denied to Scotland because it could create tax competition among the nations of the Union, then the same should apply to Northern Ireland.

Taking the above factors under consideration and assuming that there is no logical justification in denying to Scotland the power over corporate taxation, this report proposes that the Scottish government should incentivise lower corporate tax rates by utilising the Scottish Government's Business Pledge, in order to tackle income inequality and boost productivity. With regards to that, the previous sections of this report showed that there is a negative relationship between corporate tax rates and income inequality. Meanwhile, as discussed previously there is a negative relationship between income inequality and productivity growth. This implies that there may be an indirect positive relationship between corporate tax and productivity growth; the lower the tax rates the lower the productivity. Thus, UK's 'productivity puzzle' may be related indirectly to the corporate tax rates and directly to income inequality, which results from them. The data presented above shows that this could be the case, but more research is needed to prove whether there is actually a direct correlation between them.

The main drivers of productivity are commonly considered to be: investment in new equipment, machinery and buildings; innovative products, technologies and corporate structures; skilled labour force that complements investment and innovation; new entrepreneurs that increase competition and bring forth new ideas; and competition, in general, as a driver of investment, innovation and increased efficiency.[50] This report recommends then to Scottish policy-makers, to start by adding income inequality as one of the main determinants of productivity. This effectively means to start considering the negative relation between corporate tax rates and income inequality and how this may hinder economic growth by lowering productivity.

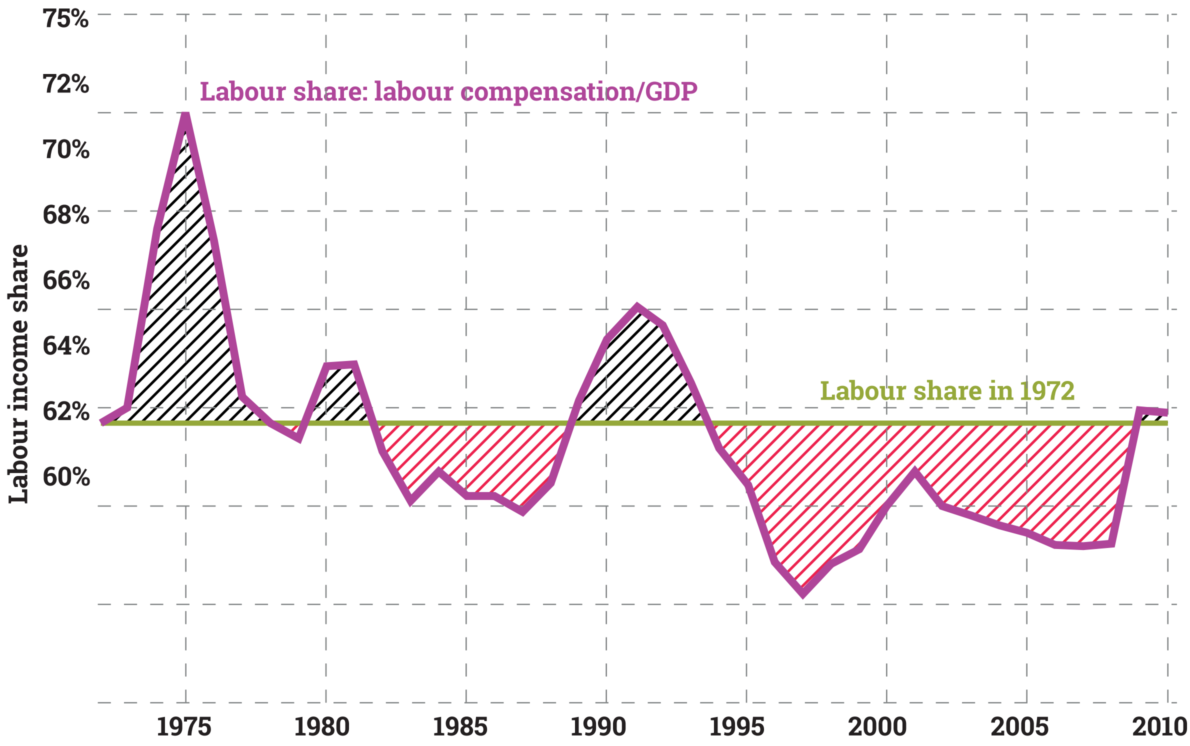
Advances in income inequality create an environment in which there is no motivation for workers to produce. This is because they feel that they do not receive a fair share from the economic growth they have largely made possible. As Figure 21 shows, the share of UK income going to labour was basically the same in 2010 as it was in 1972. This is something that, as discussed previously, does not only demotivate workers but also makes it more difficult for them to acquire skills through education. This in its turn hinders the economy's ability as a whole to provide goods and services that require high-skilled labour and thus be competitive.

A recent report by the Fraser of Allander Institute suggests that 'Scotland could close a large part of its productivity gap with the most productive OECD economies by raising

50 Camus E. (Ed.) (2007), The ONS Productivity Handbook: A Statistical Overview and Guide, (New York: Palgrave MacMillan), p. 20: https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/methodologies/productivityhandbook

its capital stock per worker. This could be achieved through higher public or private investment, or a combination of both.'[51] Indeed, investing in new machinery and equipment has the potential to assist the per-worker productivity, but this should be done in conjunction with policies that aim to decrease income inequality. This is only logical since a demotivated worker will continue to under-produce. Similarly, a person that works full-time and still is under the poverty threshold cannot be expected to be mentally in a position to be a high performer.

Figure 21: the share of labour income in UK GDP (1972-2010)



Source: ONS, OECD and KLEMS; all measures adjusted for self-employment.[52]

51 Mitchell M. & Zymek R. (2018), 'Scotland's "Middling" Productivity – An International Perspective,' Fraser of Allander Institute: https://fraserofallander.org/scottish-economy/productivity/scotlands-middling-productivity-an-international-perspective/

52 As cited in Pessoa P. J. & Van Reenen J. (2011), 'Decoupling of Wage Growth and Productivity Growth? Myth and Reality,' CEP Discussion Paper No. 1246: http://blogs.lse.ac.uk/politicsandpolicy/wage-growth-and-productivity-growth-the-myth-and-reality-of-decoupling/

Inspiring change in the economy through Scotland's business pledge

In response to that, this report proposes that corporate taxation can be used in a different way to act as one of the instruments through which sustainable economic growth can be achieved. It suggests then that by linking corporate tax rate to values and criteria that promote sustainable growth this is possible. A way of doing this would be to link corporate tax rates to the Scottish Government's Business Pledge. This approach would empower the Pledge as well as utilise the powers over corporation tax rates to achieve the sustainable growth goals of the Scottish government.

In particular, the Scottish government should not decrease the corporate tax rate any further. Instead it should bring the statutory rate up to 21%, more in line with the EU average (21.86%).[53] Secondly, it should make it possible for businesses to attain the lower/UK corporate tax rate through signing the Scottish Government's Business Pledge. This approach has the potential to raise corporate tax revenues, while maintaining a competitive tax rate, not higher than the EU average with the possibility of being as low as the UK's.

Most importantly, it actively seeks to address Scotland's disproportionate income inequality and through it the low productivity growth issue. It does so in two ways. Firstly, based on the fact that there is a negative relationship between corporate tax and income inequality, it seeks to decrease income inequality through raising corporate tax rate. Secondly, in a more active manner, it tackles income inequality through tying lower, UK level, corporate tax rates to the Scottish Government's Business Pledge.

The Scottish Government's Business Pledge is defined as a 'values-led partnership between Government and business. It is a shared ambition of boosting productivity, competitiveness, sustainable employment, and workforce engagement and development.'[54] However, very few businesses have signed up to the Pledge; 0.3% of the Scotland's registered business base. The majority of them, 65.7%, are small business, employing less than 50 people. Small businesses make up 96.3% of all the firms registered in Scotland. This means that proportionally, more medium (50-249 employees) and large (over 250 employees) businesses have signed up the pledge.[55]

There are nine pledges business can sign up. Making the Pledge, currently means, to commit to the 'paying the living wage' and two more as well as commit to all nine of them in the long-run. As the following table shows most of the nine elements of the Pledge aim to increase productivity by decreasing income inequality, eliminate exploitation, increase diversity and equality as well as make it possible for employees to engage more in the development of businesses. This is encouraging, as it shows that the Scottish government realises the importance of the workforce in the pursue of economic growth.

53 Bunn D. (2018), p. 6.
54 Scottish Business Pledge: https://scottishbusinesspledge.scot/about/
55 Scottish Business Pledge: https://scottishbusinesspledge.scot/information/scottish-business-pledge-statistical-overview-january-2019/

Table 1: number of pledge elements fulfilled by Scottish businesses, January 2019

Pledge element	Businesses	Share
Paying the living wage	577	100%
Not using exploitative zero hours contracts	577	100%
Playing an active role in the community	485	84.1%
Committing to an innovation program	475	82.3%
Committing to prompt payment	469	81.3%
Investing in youth	454	78.7%
Pursuing international business opportunities	450	78.0%
Supporting progressive workforce engagement	423	73.3%
Making progress on diversity and gender balance	221	38.3%

Source: Scottish Business Pledge: https://scottishbusinesspledge.scot/information/scottish-business-pledge-statistical-overview-january-2019/

This report the proposes, assuming that Scottish government demands from the UK government power over corporate taxation, that the Scottish government should urge companies headquartered in Scotland to sign up the Pledge by offering them the opportunity to be taxed with the UK/low rate. In particular, considering the different business sizes and the role this may play in their ability to sign the Pledge the report proposes three different approaches related to the size of the companies. These proposals are summarised in Table 2.

The proposed policy is in line with the economic strategy of the Scottish government.[56] According with the Scottish government, 80% of the companies paying the living wage, which is currently £9/per hour, believe that it has enhanced the quality of the work of their staff, while absenteeism has fallen by approximately 25%.[57] Meanwhile, not using zero-hour contracts, creates instantly a more stable working environment, with workers that are more committed and less stressed, thus more productive.

According to Gallup's global survey from 2014 to 2016, employee engagement levels vary considerably by country and region. However, the proportion of employee engagement does not exceed four out of 10 employees in any country. As the relevant report says:

> The low percentages of engaged employees represent a barrier to creating high- performing cultures around the world. They imply a stunning amount of wasted potential, given that business units in the top quartile of Gallup's global employee engagement database are 17% more productive and 21% more profitable than those in the bottom quartile.[58]

56 Scottish Government (2015), Scotland's Economic Strategy: https://www.gov.scot/publications/scotlands-economic-strategy/pages/5/#fig2.1

57 Scottish Business Pledge: https://scottishbusinesspledge.scot/living-wage/

58 Gallup (2017), State of the Global Workforce: Executive Summary, p. 4: http://www.managerlenchanteur.org/wp-content/uploads/Gallup-State-of-the-Global-Workplace-Report-2017_Executive-Summary.pdf

Table 2: summary of proposed corporate tax policy for Scotland

Business Size	Proposed Scottish Corporate Tax Rate Before Pledges	Initial Sing up to Business Pledges	Commitment to Business Pledges	Proposed Scottish Corporate Tax Rate After Pledges
Small (less than 50 employees)	21%	Paying the Living Wage, No Zero-Hour Contracts.	Commitment to fulfil all nine pledges.	19% – on the initial signing the Pledge.17% – on the year of fulfilment of all nine pledges.
Medium (50-249 employees)	21%	Paying the Living Wage, No Zero-Hour Contracts, Diversity and Gender Balance.	Commitment to fulfil all nine pledges.	19% – on the initial signing the Pledge.17% – on the year of fulfilment of all nine pledges.
Large (more than 250 employees)	21%	Paying the Living Wage, No Zero-Hour Contracts, Diversity and Gender Balance, Support Workforce Engagement.	Commitment to fulfil all nine pledges.	19% – on the initial signing the Pledge.17% – on the year of fulfilment of all nine pledges.

There is not much data available about the relationships between workforce diversity and productivity. However, the available literature, whenever it does not find a positive relationship, does not find a significantly negative association. It is expected then that policies that promote diversity and equality will not have a negative effect on productivity.

Summary of expected positive socio-economic effects of the proposed policy

If the policy proposed in this report is adopted and if business sign up to the Pledge, it is expected that in the long-run, after businesses make all nine pledges, there would be significant socio-economic benefits for businesses as well as for Scotland. Based on the information provided by the Scottish government, which reinforces and is being reinforced by what has been discussed in this report, each of the nine pledges is expected to have the results summarised in Table 3.

Table 3: expected socio-economic effects of all nine pledges

Pledges	Effect on businesses	Effect on Scotland
Living Wage	• Increased Productivity • Better Image of the Business • Less Absenteeism • More Attractive to Talent	• Decreased Income Inequality • More Prosperous Society • More Buying Power • Better Future Planning
Zero Hours Contracts	• Less Stressed Workforce • Better Reputation for Business • Stronger Business Brand • More Committed Workforce	• Enhanced Well-Being • More Trust in Workplace • A Fairer Society • A Clearer Vision for the Future
Workforce Engagement	• More Productive Workforce • Less Health and Safety Issues • Improved Innovation • Attracting High-Skilled Workers	• A Sense of Belonging • A Wealthier Society • Better Mental Health • Better Social Relationships
Balanced Workforce	• Increased Morale for Workforce • Reflects all Society • Higher Range of Skills Available • Broader Customer Base	• Higher Economic Growth • More Equal and Diverse Society • More Actively Engaged Citizens • People Feel More Represented

Pledges	Effect on businesses	Effect on Scotland
Invest in Youth	• New Ideas and Perspectives • Enthusiasm and Will to Learn • Raise Work Quality • Bring Down Recruitment Costs	• Faster Economic Growth • Young People More Actively Engaged • Empowered Local Communities • Investing on Scotland's Future
Innovation	• Faster Growth of Sales • Higher Productivity • Higher Exporting Opportunities • Higher Media Presence	• Better Trained and Educated People • Better Equipped Society • More Attractive Investment Environment • New Social Organisation iIdeas
Internationalisation	• Larger Customer Base • Expansion Opportunities • International Reputation • Higher Financial Gains	• More Integrated with Global Economy • Multicultural Society • Higher Numbers of International Visitors • More Open Society
Community	• Better Reputation • Easier Recruitment Process • Higher Press Coverage • Lesser Damage Risk	• Empowered Local Community • More Engaged Citizens • Increased Awareness about Businesses • More Efficient Leadership
Prompt Payment	• Better Relationships with Suppliers • Less Costs from Penalties • More Efficient Operating Processes • Easier Financial Forecasting	• More Efficient Local Authorities • Higher Levels of Trust • Higher Levels of Transparency • Faster Economic Processes

Incentivising corporate tax through the Scottish Business Pledge is a way of saying to the companies that Scotland is open to investment that is considerate to the needs of the people and the environment. The common tactic of tax cuts arguably leads to cheap investment as businesses end up seeing their investment as an opportunity for short-term profit rather than something out of which they can establish themselves as leaders in their fields for the years to come. In other words, the proposed policy is call to businesses to actually take their investments more seriously by considering all the future benefits it will have for them directly and indirectly.

Furthermore, it is suggested that a transitional period should be provided to companies that sign the Pledge, especially the 'small companies,' to allow them to adjust their operations in accordance with the Pledge. During this period the companies, having signed the Pledge, will be taxed at a 19% rate as stated in Table 2. The Scottish government should seek the opinions and views of businesses on the length of the transitional period as well as on the whole process, prior to its activation. In addition, a way of systematically monitoring the whole process, from the signing of the Pledge to the fulfilment of all, currently nine, pledges must be in place, to ensure the effectiveness of the policy. A public auditing body or a company mechanism of reporting progress should be established. It follows that a sanctioning mechanism should also be developed, but these, alongside with the possibility of adding more or more relevant to the needs of Scotland pledges, are issues probably better left to be decided following a public consultation or discussed in a separate report.

The report acknowledges the fact that tax incentives are not always operating or having the intended results. A detailed cost/benefit analysis of the incentives proposed here by the policy officials is also recommended. Nevertheless, based on the above analysis and for the reasons discussed in it, incentivising corporate taxation to tackle income inequality and boost productivity is, in the view of this report, the best way forward for Scotland. It is a policy that has the potential to address Scotland's needs, while promoting sustainable development in the long-run.

To conclude, it has to be stated again that an independent Scotland would have the ability to set its own fiscal policy and thus its own corporate tax policy. It could then replicate or adjust its policies in accordance with any model available. However, the recommendations put forward here consider the proximity of Scotland with the rest of the UK, the economic integration among the nations of the Union, and the fact that the Scottish government has proposed what can be defined as 'a mix market-liberal and social-investment strategies.'[59] As a result, the report considers these proposals as more viable or realistic, at least for now, without rejecting the possibility of Scotland adopting a political economy more in line with the Nordic model or higher taxation and more welfare-state policies.

continued overleaf

59 Keating M. & Harvey M. (2014), 'The Political Economy of Small European States; and lessons for Scotland,' National Institute Economic Review no.227, pp. 54-66, p. 63.

Conclusion

We recommend Benefit Corporation Tax Credits to the Scottish Government as it is a policy that has the potential to lead to the creation of a better, stronger, fairer and more sustainable Scottish economy. This is mainly because Scotianomics, as the approach of this report, views wellbeing and sustainable prosperity as the main of goal of economics. Our recommendations are based on facts and values rather than economic trends or political belief systems.

The Benefit Corporation Tax Credits policy proposed here can be the bedrock of that positive change creating a uniquely competitive business environment, which is both bespoke and adaptive to the changing needs of Scotland's economy, its business people and our society as a whole. Adopting the proposed policy, then, could have an immediate positive impact on the Scottish economy and that is why the Scottish government should demand the power over corporation tax be devolved to Scotland.

Appendix

The 'What is the Problem Represented to Be' (WPR) Method

The method has been developed by Carol Bacchi, professor of politics at the University of Adelaide, and its main aim is to facilitate critical interrogation of public policies. It starts from the premise that what one proposes to do about something reveals what one thinks is problematic (needs to change).[60] For example, if corporate tax cuts are proposed as a policy towards economic growth, this implies that the government considers this to be the problem that holds economic growth back.

The aim is to understand policies in more depth by probing the unexamined assumptions and deep-seated conceptual logics within implicit problem representations. This task is accomplished through a set of six questions and an accompanying undertaking to apply the questions to one's own proposals for change:

1. What's the 'problem' represented to be in a specific policy or policy proposal?
2. What presuppositions or assumptions underpin this representation of the 'problem'?
3. How has this representation of the 'problem' come about? How/where has this representation of the 'problem' been produced, disseminated and defended?
4. What is left unproblematic in this problem representation? Where are the silences?

Can the 'problem' be thought about differently?

5. What effects are produced by this representation of the 'problem'?
6. How has it been (or could it be) questioned, disrupted and replaced?[61]

The way the WPR approach operates is mainly through the analysis of concrete policies, and programs and policy proposals, to reveal what is represented to be the 'problem' within them. It is a method that is used to study and interpret various forms of relevant texts from the recent to distant past. These may include scientific and academic literature as well as any other type of texts such as organisational files and records, legislation, judicial decisions, speeches, interview transcripts, media statements, and reports presenting statistical data among others.

60 Bacchi C. (2012), 'Introducing the 'What's the Problem Represented to Be' Approach,' in Bletsas A. & Beasley C. (eds.), Engaging with Carol Bacchi: Strategic Interventions & Exchanges, (Adelaide: University of Adelaide Press), pp. 21-24, p. 21.

61 Bacchi C. (2012), p. 21.